91-1692 (1)

No. _____

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In The

Supreme Court of the United States

October Term, 1991

K & S PARTNERSHIP; ROBERT F. SWARTZBAUGH; RICHARD W. KELLEY; CHARLES C. MYERS; DON ERFTMIER; CARL L. BOSCHULT; WILLIAM A. LORENZ; NANCY D. LORENZ; HARLEY D. SCHRAGER; SAMUEL A. ANCONA; JOSEPH I. ANCONA; CARL ANCONA; MICHAEL J. ANCONA; BYRON D. STRATTAN; DENNIS STRAUSS; TONY LAMALFA; KEVIN J. CLOONAN; STEPHEN H. SIMON; FREDERICK J. SIMON; ALAN SIMON; GARY GUNDERSON; FRANK WOODS PETERSEN; THOMAS T. BERNSTEIN; DONALD D. GRAHAM; ALBERT BLOCH; MARK ANTHONY; EUGENE MCINTYRE; DOROTHY MCINTYRE; JOHN E. RYAN; PAUL ALPERSON; GERALD E. PALMER; RONALD K. PARSONAGE; WILLIAM W. SMITH; O. DOUGLAS OSTERHOLM; AND BERNARD MAGID,

vs. *Petitioners,*

CONTINENTAL BANK, N.A.,

Respondent.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether a corporation can be liable under 18 U.S.C. § 1962(c) of RICO for the acts of its employees and agents?

2. Whether the Seventh Amendment prohibits a court of appeals from considering and weighing conflicting evidence in determining the sufficiency of the evidence in support of a jury verdict?

PARTIES TO THE PROCEEDING

The caption of the case in this Court contains the names of all parties to the proceeding in the United States Court of Appeals for the Eighth Circuit (Supreme Court Rule 14.1(b)).

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Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

PETITION FOR WRIT OF CERTIORARI

OPINIONS BELOW

The Eighth Circuit did not deliver a substantive opinion when it denied petition for rehearing, with a

suggestion for rehearing en banc, on January 23, 1992. The full opinion, decided December 6, 1991, is officially reported at 952 F.2d 971 (8th Cir. 1991). The opinion of the district court partially granting Defendant's Motion for Judgment Notwithstanding the Verdict, filed September 18, 1989, is officially reported at 127 F.R.D. 664 (D. Neb. 1989).

The Eighth Circuit opinion filed December 6, 1991, is contained in the Appendix beginning at A-1. The district court decision filed September 18, 1989, is contained in the Appendix at A-24.

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) and 28 U.S.C. § 2101(c). The judgment denying rehearing of the Court of Appeals for the Eighth Circuit was entered January 23, 1992. This Petition is timely, having been filed within ninety (90) days of that date.

PROVISIONS OF STATUTE AND CONSTITUTIONAL AMENDMENT INVOLVED

The statutory provisions of Title 18, United States Code, added by Title IX (RICO) of P.L. 91-452, in relevant part, provides:

> § 1962. Prohibited activities. . . .
>
> (c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to

> conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

The Seventh Amendment to the United States Constitution provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

STATEMENT OF THE CASE

A. Proceedings and Disposition Below.

This is an action brought by 35 investors ("Petitioners") against Continental Bank, N.A. ("Continental"), for Continental's participation in a fraudulent scheme. Petitioners allege that Continental was liable for (1) aiding and abetting securities fraud, (2) conspiracy to violate the federal securities laws, (3) knowing participation in breaches of fiduciary duty, and (4) violating RICO. Jurisdiction was based upon 28 U.S.C. § 1331 and 18 U.S.C. § 1964.

A three week jury trial was held, and on April 19, 1989, the jury found in favor of the Petitioners on all four theories of recovery. The district court entered judgment on May 15, 1989, in the amounts of $1,350,317.32 on each of the three non-RICO counts, and in the amount of $4,856,250.52 under RICO.

On September 18, 1989, the district court overruled Continental's motion for judgment notwithstanding the verdict on the three non-RICO counts, but granted the motion j.n.o.v. on the RICO count on the single ground that as a matter of law, Continental could not be held liable for the acts of its employees under RICO. Continental filed a notice of appeal on September 22, 1989. The Petitioners also appealed from the grant of the motion for j.n.o.v. with respect to the RICO count.

Oral arguments were heard before the United States Court of Appeals for the Eighth Circuit on May 14, 1990. An initial Opinion was filed September 12, 1990, reversing the district court's judgment entered on the three non-RICO counts, and affirming the district court's grant of Continental's motion for judgment notwithstanding the verdict. Petitioners filed a petition for rehearing with a suggestion for rehearing en banc, and the Eighth Circuit withdrew its initial Opinion and Judgment on January 23, 1991.

The Eighth Circuit issued another Opinion on December 6, 1991, and did not change the result of the initial Opinion. The second opinion attempted to clarify the standard of review applied. Petitioners again filed a petition for rehearing, with a suggestion for rehearing en banc, which was denied on January 23, 1992. Petitioners now seek certiorari.

B. Factual Allegations.

Petitioners allege that from 1979 through 1981, Continental participated in a fraudulent scheme that defrauded Petitioners in connection with the purchase of securities.

In 1978, Continental entered into an agreement with Penn Square Bank, N.A., formerly of Oklahoma City, Oklahoma, to purchase any and all energy loans that Penn Square could originate regardless of quality. Under the agreement, Continental agreed to immediately book the loans, and review their quality at a later time. If Continental ultimately chose not to keep a loan, Continental assisted in the placement of the loan with another large bank such as Michigan National Bank or Seattle First National Bank. In essence, the loans were "parked" at Continental regardless of quality under this agreement.

Petitioners purchased limited partnership interests in nine different oil and gas drilling partnerships formed by Eagle Petroleum Corporation ("Eagle"). Petitioners paid for their securities by paying 25% cash, and causing letters of credit to be issued in favor of Penn Square Bank in an amount constituting 75% of the purchase price. These letters of credit in turn secured drilling loans made to Eagle by Penn Square Bank pursuant to its agreement with Continental.

Oil and gas promoters such as Eagle could not raise significant amounts of money from investors without a track record. In order for letter of credit programs to build a track record, they had to obtain "production loans" secured by oil and gas reserves, and release the letters of credit securing the drilling loans. Continental, through its association and agreement with Penn Square Bank, aided and abetted Eagle in fabricating a false track record that assisted Eagle to fraudulently sell securities to Petitioners.

In February 1980, the Continental-Penn Square enterprise began converting Eagle letter of credit loans to

production loans for the earliest partnerships despite insufficient oil and gas reserves. Uncontradicted expert testimony at trial established that all of Eagle's production loans were under-collateralized by oil and gas reserves, and that the letters of credit should have been called in each instance. The evidence also established that Eagle offering documents touted the fact that Eagle had never had a letter of credit called. These offering documents were regularly sent to Penn Square and Continental before the offerings.

Petitioners contended Continental knew that calls of letters of credit would be harmful to the marketing of future oil and gas programs by a promoter, and further knew that Eagle was touting its track record of "never having a letter of credit called" in its offering documents. John Lytle, Executive Vice President at Continental in charge of the division participating in the energy loans with Penn Square Bank, and William Patterson, Senior Vice President at Penn Square Bank in charge of its energy loans, asserted their Fifth Amendment privilege against self-incrimination instead of answering any questions about Continental or Penn Square's relationship with Eagle. The evidence was further undisputed that Lytle received $565,000 in favorable insider loans from Penn Square, which, when discovered by other Continental executives, did not cause Continental to fire Lytle, but instead resulted in an increase in Lytle's lending authority. Both Lytle and Patterson were convicted of felony crimes involving dishonesty and were in prison during the trial.

After hearing three weeks of evidence, the jury found Continental to be liable for its participation in the pyramid scheme. The district court denied Continental's motion for j.n.o.v. for the non-RICO claims, but found that Continental could not be held vicariously liable under RICO for the acts of John Lytle and other employees. In making this ruling, the district court clearly drew inferences in favor of the verdict loser and concluded that Petitioners failed to prove that the scheme was part of Continental's "policy goals." (A-37).

The Eighth Circuit went even further on appeal and reversed the district court's denial of j.n.o.v. with respect to the non-RICO claims. The Eighth Circuit ignored any favorable inferences that should be drawn and were drawn by the jury from the assertion of the Fifth Amendment privilege by both Lytle and Patterson and the insider loan bribes paid to Lytle. In making its ruling, the Eighth Circuit not only substituted its judgment for that of the jury, it expressly considered conflicting evidence favoring Continental, the verdict loser. The Eighth Circuit further affirmed the district court's granting of j.n.o.v. with respect to RICO on the basis of the district court's opinion below.

REASONS FOR GRANTING THE WRIT

This case presents the Court with the ideal opportunity to resolve confusion in the circuits with respect to (1) liability of corporate defendants under § 1962(c) of RICO, and (2) the proper standard for determining the sufficiency of the evidence to support a jury verdict.

A. *Respondeat Superior* under RICO.

In order to establish a RICO cause of action under 18 U.S.C. § 1964(c), four elements must be proven. These elements are (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity. *Sedima S.P.R.L. v. Imrex Company, Inc.*, 473 U.S. 479, 496 (1985). In the case at bar, the district court (affirmed by the Eighth Circuit) grafted an additional element to a RICO § 1962(c) cause of action that must be proven before an injured party can prevail. Under this view, a RICO plaintiff must prove a fifth element: (5) that the illegal activities represent official corporate policy.

In *Sedima* and *H.J. Inc. v. Northwestern Bell Telephone Co.*, 492 U.S. 229 (1989), this Court instructed the courts of appeal and the district courts to avoid creating artificial barriers against RICO liability not found in the express language of the statute. Yet, in the case at bar, the district court and the Eighth Circuit once again have departed from the clear language of the statute and added an additional element of liability under § 1962(c).

There is a clear conflict in the circuits on this issue. The Eighth Circuit has taken the most restrictive position. In *Luthi v. Tonka*, 815 F.2d 1229, 1230 (8th Cir. 1987), which was followed in the present case, the Eighth Circuit indicated that corporations can never be liable under the *respondeat superior* doctrine in a § 1962(c) case. Other circuits have recognized, on the other hand, that a corporation can be held liable under the doctrine of *respondeat superior* for a § 1962(c) violation provided it is separate from the RICO enterprise. *Petro-Tech, Inc. v. Western Co. of*

North America, 824 F.2d 1349, 1361-62 (3d Cir. 1987); *Ashland Oil, Inc. v. Arnett*, 872 F.2d 1271, 1281 (7th Cir. 1989). At the far end of the spectrum, the Eleventh Circuit has held in a criminal case that a corporation can violate § 1962(c) even if it is the RICO enterprise. *United States v. Hartley*, 678 F.2d 961, 988 (11th Cir. 1982), *cert. denied*, 459 U.S. 1170, 1183 (1983).

In the case at bar, the district court cited *Luthi v. Tonka* and *D & S Auto Parts, Inc. v. Schwartz*, 838 F.2d 964, 966-68 (7th Cir.) *cert. denied*, 486 U.S. 1061 (1988), and held "that before RICO liability may be imposed it must be proven that it was the corporate policy which created the scheme or senior corporate management implemented scheme." (A-33, 35). As *D & S Auto Parts* was expressly narrowed by the Seventh Circuit in *Ashland Oil*, and this additional requirement is not found in the statute, the district court's ruling as affirmed by the Eighth Circuit is seriously flawed.

The cases simply cannot be reconciled, and confusion will remain unless this Court settles the conflict by granting certiorari in the case at bar. Moreover, the Court has voted to review the question presented in *Reves v. Ernst & Young*, 91-886. In *Reves*, an investor requested review of the Eighth Circuit's restrictive interpretation of the phrase "to conduct, directly or indirectly, in the conduct of [the] enterprise's affairs" contained in § 1962(c). By granting certiorari in the case at bar as well, the Court can also resolve the confusion that exists concerning the imposition of vicarious liability under § 1962(c).

B. The Proper Standard of Review for Granting Judgments as a Matter of Law.

The instant case also presents this Court the opportunity to set a uniform standard for reviewing the sufficiency of the evidence supporting a jury verdict. In reversing the jury verdict on the non-RICO claims, the Eighth Circuit expressly considered evidence supporting Continental's position on appeal, and rejected evidence favoring the verdict winners. (A-19). There was clearly probative evidence supporting the jury's finding that Penn Square acted as Continental's agent, but the Eighth Circuit simply rejected it. The "Certificates of Participation" executed by Continental and Penn Square with respect to each loan "parked" at Continental *expressly* authorized Penn Square to act on behalf of Continental. Penn Square was given the express authority to release letters of credit and replace them with other collateral. Yet, the Eighth Circuit rejected this evidence, and expressly considered conflicting evidence in overturning the jury's findings.

Effective December 1, 1991, Fed.R.Civ.P. 50 was amended, abandoning the terminology "directed verdict" and "judgment notwithstanding the verdict" in favor of "judgment as a matter of law." In adopting this amendment, the Advisory Committee stated that the amendment "effects no change in the existing standard" and "is not an intrusion on any responsibility for factual determinations conferred on the jury by the Seventh Amendment. . . . "

The opinion of the Eighth Circuit in the case at bar is a clear violation of Petitioners' Seventh Amendment right

to have a jury, not an appellate court, make fact determinations. The opinion violates the holding in *Lavender v. Kurn*, 327 U.S. 645, 653 (1946):

> Only when there is a complete absence of probative facts to support the conclusion reached does a reversible error appear. . . .

Petitioners are not aware of any case since *Lavender*, in which the Supreme Court has taken a jury verdict away because the Court believed the weight of the evidence to be too slight. E. Schnapper, *Judges Against Juries – Appellate Review of Federal Civil Jury Verdicts*, 1989 Wis. L. Rev. 237, 264. In *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986), this Court reaffirmed the role of a jury:

> Credibility determinations, the weighing of evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge, whether he is ruling on a motion for summary judgment or for a directed verdict. The evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor.

As discussed *infra*, the circuits have clearly adopted very different standards for overturning jury verdicts. The present case provides this Court an opportunity to direct circuit courts and district courts to exercise proper judicial restraint and adhere to the command of the Seventh Amendment. Petitioners respectfully request this Court to grant certiorari on this important issue that arises in virtually every civil jury trial.

I.

CERTIORARI SHOULD BE GRANTED BECAUSE A CONFLICT EXISTS AMONG THE CIRCUITS CONCERNING THE APPLICABILITY OF THE DOCTRINE OF *RESPONDEAT SUPERIOR* IN RICO CASES.

This Court has previously instructed the circuits and the district courts to look to the Clayton Act in construing RICO because both "are designed to remedy economic injury by providing for the recovery of treble damages, costs and attorneys' fees." *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 483 U.S. 143, 151 (1987). *See also Holmes v. Securities Investor Protection Corp.*, No. 90-727, 1992 WL 52846 (March 24, 1992) ("We have repeatedly observed . . . that Congress modeled § 1962(c) on the civil-action provision of the federal antitrust laws. . . . ").

Under the federal antitrust laws, this Court has soundly rejected the argument that a corporation should not be held liable for the acts of its agents. *American Society of Mechanical Engineers, Inc. v. Hydrolevel Corp.*, 456 U.S. 556, 570-73 (1982). In the antitrust context, the Supreme Court carefully analyzed the pros and cons of imposing liability vicariously and concluded that corporations must be held accountable in order to promote the remedial objectives of the antitrust laws. *Id.*

In RICO cases, several circuits have refused to follow the Supreme Court's directive and reasoning with respect to *respondeat superior* liability under the Clayton Act. The First Circuit has decided that the antitrust analogy should not apply because "the legislative history [of RICO] tells us that Congress has a specific target in mind with this statute, the individual wrongdoer, in contrast with the more general purposes behind the antitrust and securities

acts." *Schofield v. First Commodity Corp. of Boston*, 793 F.2d 28, 33 (1st Cir. 1986).

The Eighth Circuit has interpreted *Schofield* to mean that corporations would never be liable under the *respondeat superior* doctrine in a § 1962(c) case. *Luthi v. Tonka*, 815 F.2d 1229, 1230 (8th Cir. 1987). The Eighth Circuit affirmed this position in the case at bar by referencing the district court's "thorough memorandum opinion." (A-23).

The Third and the Seventh Circuits have rejected this narrow view. *Petro-Tech, Inc. v. The Western Co. of North America*, 824 F.2d 1349, 1359 (3rd Cir. 1987); *Ashland Oil, Inc. v. Arnett*, 872 F.2d 1271, 1281 (7th Cir. 1989). These circuits recognize that vicarious liability may be imposed under § 1962(c) provided that the corporate defendant is not also alleged to be the "enterprise," but is instead the person conducting the affairs of a separate enterprise. *Id.*

Other circuits have refused to hold a corporation liable under § 1962(c) if it was also the RICO enterprise. *Landry v. Air Line Pilots Ass'n. Int'l. AFL-CIO*, 901 F.2d 404, 425 (5th Cir.) *cert. denied*, 111 S.Ct. 244 (1990); *Yellow Bus Lines, Inc. v. Drivers, Chauffeurs and Helpers Local Union 639*, 839 F.2d 782, 791 (D.C. Cir. 1988), *judgment vacated*, 492 U.S. 914 (1989) (remanded for further consideration in light of *H.J. Inc. v. Northwestern Bell Telephone Company*, 492 U.S. 229 (1989)).

Confusion runs rampant in the district courts. *See, e.g. Collective Fed. Sav. v. Creel*, 746 F. Supp. 1307, 1308-09 (M.D. La. 1990); *Harrison v. Dean Witter Reynolds, Inc.*, 715 F. Supp. 1425, 1429-32 (N.D. Ill. 1989); *In re Citisource, Inc. Sec. Litig.*, 694 F. Supp. 1069, 1080 (S.D.N.Y. 1988); *Connors v. Lexington Ins. Co.*, 666 F. Supp. 434, 453 (E.D.N.Y. 1987);

Bernstein v. IDT Corp., 582 F. Supp. 1079, 1083 (D. Del. 1984).

It is clear that the circuit and district courts need guidance from this Court on this critical issue. Otherwise, RICO plaintiffs may prevail in the Third and Seventh Circuits, but be barred from the courthouses in the First and Eighth Circuits. Petitioners respectfully submit that the case at bar presents the Court with an ideal case for resolving the clear conflict.

II.

CERTIORARI SHOULD BE GRANTED BECAUSE A CONFLICT EXISTS CONCERNING THE PROPER STANDARD OF REVIEW FOR DETERMINING THE SUFFICIENCY OF THE EVIDENCE TO SUPPORT A JURY VERDICT.

A. There is no Uniform Standard.

From 1938 to 1968, the Supreme Court regularly granted certiorari and reversed circuit courts when they overturned a jury verdict because of a perceived insufficiency of the evidence. E. Schnapper, *Judges Against Juries – Appellate Review of Federal Civil Jury Verdicts*, 1989 Wis. L. Rev. 237, 240-41. *See, e.g., Utah Pie Co. v. Continental Baking Co.*, 386 U.S. 685 (1967) (certiorari granted to reinstate verdict in action arising under the Clayton Act); *International Terminal Operating Co. v. Nederl*, 393 U.S. 74, 75, *judgment amended*, 393 U.S. 995 (1968) ("under the Seventh Amendment, [the disputed factual issue] should have been left to the jury's determination.").

Since 1968, however, the Supreme Court has not granted certiorari to consider whether the Seventh

Amendment has been violated when jury verdicts are overturned on the ground of insufficient evidence. 1989 Wis. L. Rev. at 245. As a result, circuit courts have continually departed from the doctrine of judicial self-restraint guaranteed by the Seventh Amendment and have overturned jury verdicts at an alarming rate. *Id.* at 247-48 (in 208 cases decided in a one year period, 49% of the jury verdicts challenged on the ground of insufficiency of the evidence were overturned).

The circuit courts and district courts use different standards to circumvent the express dictates of the Seventh Amendment. The Seventh Circuit has expressly recognized that it will "weigh the evidence to the extent of determining whether the evidence to support the verdict is *substantial.*" *La Montagne v. American Convenience Products, Inc.*, 750 F.2d 1405, 1410 (7th Cir. 1984) (emphasis in original).

The Eighth Circuit has been internally inconsistent. In the case at bar, the Eight Circuit panel expressly rejected the verdict winner's evidence in favor of evidence supporting the verdict loser. (A-19). Yet, in *Morgan v. Arkansas Gazette*, 897 F.2d 945, 948 (8th Cir. 1990), the majority opinion emphasized that the appellate court must limit its review to evidence supporting the verdict winner. *See also Dace v. ACF Industries*, 722 F.2d 374, 376-77 (8th Cir. 1983), *mod. per curiam*, 728 F.2d 976 (8th Cir. 1984); *Clements v. General Accident Insurance Co. of America*, 821 F.2d 489, 491 (8th Cir. 1987); *Williams-El v. Johnson*, 872 F.2d 224, 228 (8th Cir.), *cert. denied*, 493 U.S. 824 (1989). The Eighth Circuit has also indicated that a middle standard may be appropriate. *Caudill v. Farmland*

Industries, Inc., 919 F.2d 83, 86 (8th Cir. 1990) ("uncontroverted evidence" favoring the verdict loser may be considered in certain circumstances).

This Court has held that an appellate court should disregard evidence militating against the verdict reached by the jury. *Dennis v. Denver R.G.W.R.R.*, 375 U.S. 208, 210 (1963); *Webb v. Illinois Cent. R.R. Co.*, 352 U.S. 512, 513-14 (1957); *Wilkerson v. McCarthy*, 336 U.S. 53, 57 (1949). Yet, many of the circuits have expressly considered "all" of the evidence in determining the sufficiency of the evidence on appeal. *See Keiser v. Coliseum Properties, Inc.*, 764 F.2d 783, 785 (11th Cir. 1985); *Eyre v. McDonough Power Equip., Inc.*, 755 F.2d 416, 419 (5th Cir. 1985); *Grogan v. General Maintenance Serv. Co.*, 764 F.2d 444, 447 (D.C. Cir. 1985); *Quaker City Gear Works v. Skil Corp.*, 747 F.2d 1446, 1454 (Fed. Cir. 1984), *cert. denied*, 471 U.S. 1136 (1985); *Western Plains Serv. Corp. v. Ponderosa Dev. Corp.*, 769 F.2d 654, 656 (10th Cir. 1985); *Rhea v. Massey-Ferguson, Inc.*, 767 F.2d 266, 269 (6th Cir. 1985).

B. This Court Should Clarify the Standard of Review.

The case at bar presents this Court with an opportunity to reaffirm the doctrine of judicial restraint that is expressly incorporated into the Seventh Amendment. Mr. Chief Justice Rehnquist has recognized that the Seventh Amendment represents our founders' intent to protect the determinations of juries from the interference by judges:

> The founders of our Nation considered the right of trial by jury in civil cases an important bulwark against tyranny . . . a safeguard too

> precious to be left to the whim of . . . the judiciary. . . . Trial by a jury of laymen rather than by the sovereign's judges was important to the founders because juries represent the layman's common sense, . . . and thus keep the administration of law in accord with the wishes of the community. . . . Those who favored juries believed that a jury would reach a result that a judge either could not or would not reach.

Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322, 343-44 (1979) (Rehnquist, J., dissenting).

When Fed.R.Civ.P. 50 was amended effective December 1, 1991, the Advisory Committee stated that the abandonment of the "directed verdict" and "judgment notwithstanding the verdict" terminology "effects no change in the existing standard" and "is not an intrusion on any factual determinations conferred on the jury by the Seventh Amendment. . . . " As illustrated in the preceding discussion, there is no uniform "existing standard." Thus, it is imperative that this Court provide the circuits and the district courts with the correct standard.

Rule 50, as amended, allows a trial judge to make findings as a matter of law at any time during a trial. In doing so, should the trial judge weigh controverted evidence? On appeal, is it proper for the court of appeals to consider evidence favoring the verdict loser? The answer to these questions should not depend upon the particular jurisdiction in which the case is brought.

C. This Case Presents the Court with an Ideal Opportunity to Set Forth a Uniform Standard.

The Eighth Circuit opinion in the case at bar violated the Seventh Amendment rights of Petitioners. In determining there was no evidence to support the jury verdict, the Eighth Circuit prefaced its account of the facts by referring to a book, M. Singer, *Funny Money* (1985), which was outside the record and never considered by the jury. (A-4 n.2). The Eighth Circuit rejected *uncontradicted* expert testimony and the findings of the Tone Report (an investigative report covering Continental's relationship with Penn Square) in concluding that Continental's actions were not "atypical." Instead of considering record evidence, the Eighth Circuit relied upon a district court opinion that was not part of the evidence at trial, *Chase Manhattan Bank, N.A. v. FDIC*, 554 F. Supp. 251 (W.D. Okla. 1983), and concluded that many banks were making similar loans through Penn Square. (A-5).

The Eighth Circuit improperly considered controverted evidence supporting Continental in determining three critical factual determinations made by the jury. The following table summarizes this improper appellate weighing of evidence:

Jury's Conclusion	Petitioners' Evidence[1]	Continental's Evidence	8th Circuit's Conclusion
Penn Square was Continental's Agent.	Certificates of Participation; manner of doing business from 1978 through June 1982.	Conflicting paragraph in Loan Agreements (A-19).	Penn Square was *not* Continental's agent.
Continental knew of fraudulent scheme.	Inferences drawn from atypical banking practices; 5th Amendment inferences; "loan parking" agreement between Penn Square and Continental; Tone Report; Lytle's insider loans.	Continental's ultimate participation in 5 of the 9 programs in which Petitioners invested (A-9); loans were not atypical (A-20).	Continental did *not* know of fraudulent scheme.

[1] During a three week trial, much more evidence was adduced respecting the Penn Square-Continental relationship and the Eagle fraudulent sale of securities than can be summarized in this table. This table is offered only for purposes of illustrating the misapplication of the standard of review by the Eighth Circuit.

Jury's Conclusion	Petitioners' Evidence	Continental's Evidence	8th Circuit's Conclusion
Continental substantially assisted the Eagle fraud.	Temporarily parked loans at Continental; petroleum engineers knew "parked" loans were bad; after allowing the loans to temporarily stay at Continental, shifted them to Seafirst and Michigan Nat'l.	Disclaimers in offering materials (A-21).	Continental did *not* substantially assist the Eagle fraud.

Under a proper standard of review, there was sufficient evidence to create a jury question concerning whether: (1) Continental engaged in atypical banking transactions, (2) Penn Square acted as Continental's agent, (3) Continental knew Eagle was touting the fabricated track record built by the under-collateralized loans, and (4) Continental rendered substantial assistance by participation in the under-collaterized loans pursuant to its loan parking agreement with Penn Square. After a three week trial, the jury found in favor of the Petitioners on all of these issues, and the district court agreed that the evidence was sufficient to support the jury's conclusions on these issues. (A-10).

As the instructions to the jury (which were unchallenged on appeal) required the jury to find the three elements of aiding and abetting, including *actual* knowledge by Continental of Eagle's fraud on the investors, the foregoing evidence, which must be assumed as true, is sufficient to withstand a review by an appellate court under the proper standard. Moreover, the "knowledge" and "substantial assistance" elements of aiding and abetting can be inferred from "atypical" business actions. *See Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 97 (5th Cir. 1975), relied upon in *Metge v. Baehler*, 762 F.2d 621 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986); *Woods v. Barnett Bank of Ft. Lauderdale*, 765 F.2d 1004, 1012 (11th Cir. 1985). As the underlying fraud was conceded on appeal, and there was evidence of "atypical" business actions from which the jury could reasonably infer knowledge and substantial assistance, there was sufficient evidence that all three elements of aiding and abetting were satisfied.

Petitioners respectfully submit that the Eighth Circuit in the case at bar ignored record evidence in setting forth the facts in its opinion. Regarding the issue of Continental's atypical banking practices, in addition to the testimony of the only banking expert to testify (Tr. 1864), the jury heard evidence of substantial atypical practices that was summarized best in the Tone Report as follows:

> In general, there is substantial evidence that loans were disbursed without the approval of officers having the requisite lending authority; that the creditworthiness of borrowers was not sufficiently checked; that loans secured by reserves were disbursed without confirmation by the Bank's engineers of the value of the reserves; *that loans which could not be justified by proven reserves were approved through the use of additional types of collateral which were insufficient;* that in a number of instances security interests were not perfected; *that at periodic intervals, Lytle caused the Bank to purchase groups of Penn Square participations without proper credit investigation, to relieve Penn Square's recurrent "liquidity crunches"*; that Lytle tolerated improper actions by Bill G. Patterson, Executive Vice-President of Penn Square, such as filling out the Bank's CRF forms for a loan or deceiving a loan officer into believing that Lytle had approved a loan when he had not done so; that loans were disbursed without preparation of notesheets or furnishing sufficient data to permit them to be rated; that there were severe problems of lack of loan and collateral documentation and past due payments in connection with Penn Square loans; that the past due notices and exception reports generated as a result of these deficiencies were largely ignored and, in any event, never cleared

> up by Lytle; and that Redding (whose office was adjacent to Lytle's) had knowledge of or at least warning about many of these matters and took no effective action to correct them. 127 F.R.D. at 671 (emphasis supplied).

Notwithstanding this evidence, the Court concluded that letter of credit and production loan participations "were hardly an atypical practice for banks in the late 1970s and early 1980s." (A-20). Petitioners submit that the Court misperceived the issue of atypicality when it ignored the foregoing evidence in the record. Moreover, the Court completely ignored the expert testimony that Eagle's experience and expertise was insufficient to justify Continental's decision to open a banking relationship through Penn Square as early as 1978 (Tr. 1804), and that other banks in the "oil patch" turned down letter of credit limited partnerships such as Eagle (Tr. 1807), thus creating an inference of a questionable relationship from the outset.

On the critical issue of agency, the jury was told and shown copies of the Certificates of Participation evidencing each Continental loan which contained express language appointing Penn Square to act for Continental.[2]

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[2] The Certificates of Participation supported the jury finding that Penn Square was Continental's agent, and Penn Square's knowledge of the conversions of the letter of credit loans was reasonably imputed to Continental by the jury. *See Gottsch v. Bank of Stapleton*, 235 Neb. 816, 826-28, 458 N.W.2d 443 (1990) (court found agency in similar banking relationship). *See also, Flink v. Carlson*, 856 F.2d 44, 46 n. 2 (8th Cir. 1988) ("since that question involving the 'general law' of contracts and agency, federal courts look to state law in shaping federal law".)

These documents were signed by both Continental and Penn Square from 1978 through 1982. Yet, the Court rejected this evidence, and expressly relied on conflicting evidence. (A-19).

The record also contains sufficient evidence from which the jury could reasonably infer Continental's knowledge of Eagle's fabricated track record and its assistance in building the false track record. Continental discussed Eagle's track record with Eagle in 1978. (Tr. 649). Continental knew that a track record was important in order for a drilling promoter to sell limited partnership interests. (Tr. 650). Continental knew that calls of letters of credit would signify an unsuccessful program. (Tr. 650 and 1013). Continental knew that Eagle was touting its fabricated track record to sell securities. (Tr. 390-91; 1406; 2651-52). A Continental employee testified the Continental employees "often" reviewed offering materials "because they were the only source of material that we had on the loan." (Tr. 1406). The offering materials touted the "never had a letter of credit called" track record.

Continental further knew that its own petroleum engineer called the letter of credit loans "garbage" and that letter of credit loans were being converted to production loans based upon insufficient reserves. (Tr. 1122-24, Ex. 21; Tr. 1140, Ex. 39; Tr. 1231-32, Ex. 38). Continental knew that Penn Square loans were being put on Continental's books without performing any credit analysis. (Tr. 1450-55; Kenefick Memo Ex. 93). Additionally, there was expert testimony that from February 1980 through July 1982, the Continental-Penn Square enterprise converted Eagle letter of credit loans to production loans despite insufficient oil and gas reserves. (Tr. 1815-58).

Finally, there was the evidence that John Lytle, the Continental senior vice-president in charge of the Penn Square relationship, took the Fifth Amendment and refused to testify as to any matters concerning Eagle. (Tr. 2315). Lytle received $565,000.00 in favorable "insider" loans from Penn Square during the relevant period. After the loans were officially discovered by Continental, Lytle was not fired, but instead received an increase in his lending authority to $10 million. (Tr. 1017-20). The jury was properly instructed that it could draw favorable inferences from this failure to testify, and Petitioners contend that the jury could reasonably conclude that Continental fully approved of the Penn Square relationship because of its failure to fire Lytle. The jury was further informed that in assessing Lytle and William Patterson's (senior vice-president of Penn Square) credibility, that both of them had been convicted on August 30, 1988, of felony crimes involving dishonesty. (Tr. 2314-15).

CONCLUSION

The Petitioners respectfully request this Court to grant certiorari to resolve the clear conflict in the circuits and district courts concerning the applicability of the doctrine of *respondeat superior* to actions brought under § 1962(c) of RICO and to set a uniform standard of reviewing the sufficiency of the evidence to support a

jury verdict. The case at bar presents the Court with an ideal opportunity to address these important issues.

Dated: April 22, 1992

Respectfully submitted,

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APPENDIX

United States Court of Appeals
FOR THE EIGHTH CIRCUIT

No. 89-2678

K & S Partnership, Robert F. Swartzbaugh; Richard W. Kelley, Charles C. Myers, Don Erftmier, Carl L. Boschult, William A. Lorenz, Nancy D. Lorenz, Harley D. Schrager, Samuel A. Ancona, Joseph I. Ancona, Carl Ancona, Michael J. Ancona, Byron D. Strattan, Dennis Strauss, Tony LaMalfa, Kevin J. Cloonan, Stephen H. Simon, Frederick J. Simon, Alan Simon, Gary Gunderson, Frank Woods Petersen, Thomas T. Bernstein, Donald D. Graham, Albert Block, Mark Anthony, Eugene McIntyre, Dorothy McIntyre, John E. Ryan, Paul Alperson, Gerald E. Palmer, Ronald K. Parsonage, William W. Smith, O. Douglas Osterholm, and Bernard Magid,

Appellees,

v.

Continental Bank, N.A.,

Appellant.

No. 89-2679

Appeals from the United States District Court for the District of Nebraska.

K & S Partnership, Robert F. Swartzbaugh; Richard W. Kelley, Charles C. Myers, Don Erftmier, Carl L. Boschult, William A. Lorenz, Nancy D. Lorenz, Harley D. Schrager, Samuel A. Ancona, Joseph I. Ancona, Carl Ancona, Michael J. Ancona, Byron D. Strattan, Dennis Strauss, Tony LaMalfa, Kevin J. Cloonan, Stephen H. Simon, Frederick J. Simon, Alan Simon, Gary Gunderson, Frank Woods Petersen, Thomas T. Bernstein, Donald D. Graham, Albert Block, Mark Anthony, Eugene McIntyre, Dorothy McIntyre, John E. Ryan, Paul Alperson, Gerald E. Palmer, Ronald K. Parsonage, William W. Smith, O. Douglas Osterholm, and Bernard Magid,

Appellants,

v.

Continental Bank, N.A.,

Appellee.

Submitted: January 23, 1991
Filed: December 6, 1991

Before JOHN R. GIBSON, FAGG, and WOLLMAN, Circuit Judges.

WOLLMAN, Circuit Judge.

On September 12, 1990, we filed our opinion reversing the jury verdict entered in favor of K & S Partnership and other plaintiffs (plaintiffs) and affirming the judgment notwithstanding the verdict entered in favor of Continental Bank, N.A. (Continental). Thereafter, plaintiffs filed a petition for rehearing, with a suggestion for rehearing en banc, alleging that our opinion had applied a standard of review to the motion for judgment notwithstanding the verdict that was in conflict with the standard of review heretofore adopted by this court. After careful review, we concluded that our opinion employed language that might be read by some as being in conflict with that used in our earlier opinions. Because it was not our intention to in any way depart from the well-established standard of review laid down by our prior opinions, we vacated our September 12, 1990, opinion on January 23, 1991. We now file this opinion in its place.

Continental Bank appeals from the district court's[1] judgment in favor of plaintiffs entered on a jury verdict

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[1] The Honorable Richard G. Kopf, United States Magistrate for the District of Nebraska, presided at trial pursuant to the parties' consent.

that awarded plaintiffs damages under theories of Continental's secondary liability to plaintiffs. Plaintiffs cross-appeal from the district court's grant of judgment notwithstanding the verdict on their Racketeer Influenced and Corrupt Organizations Act (RICO) claim. We reverse the judgment entered on the jury verdict and affirm the district court's judgment notwithstanding the verdict.

I.

We summarize the evidence produced at trial, viewing it in the light of the standard of review set forth later in this opinion. In the late 1970s and early 1980s, Penn Square Bank (Penn Square) of Oklahoma City, Oklahoma, loaned money extensively for oil and gas exploration and production.[2] Included in this lending were "drilling loans" made to Eagle Petroleum Company and its two principals, Wesley Markle and Terry Stanhagen (collectively Eagle), to explore for oil and gas. Eagle secured the loans with letters of credit that the limited partners in its oil and gas programs obtained from their own banks in favor of Penn Square. In most cases the letters of credit, along with cash paid directly to the partnerships, constituted the limited partners' investment in the programs. Using letters of credit as collateral allowed investors to take tax deductions for the entire amount of their investment instead of just the cash portion. The letters of credit in the Eagle programs generally expired after two years,

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[2] For a highly readable account of Penn Square's rise and fall and of Continental's participation, along with that of several other major banks, in Penn Square's ultimately ill-fated oil gas lending policies, *see* M. Singer, *Funny Money* (1985).

and the drilling loans were repayable approximately three months prior to that time.

Under standard practice, before the drilling loan came due the partnership would apply for a "production loan" to produce and sell the oil and gas that had been discovered. When making a production loan, the bank would release the limited partners' letters of credit and substitute the oil and gas reserves as collateral. If, however, the bank refused to grant a production loan, the bank would call the letters of credit and use the proceeds to satisfy the outstanding drilling loan.

Banking regulations limited Penn Square's lending to a percentage of its capital, and further limited the amount it could lend to any single borrower. Thus, for Penn Square to make new loans it needed other banks to participate in or purchase a share of its loan portfolio. Because the oil and gas industry was thriving at the time, there was competition among major banks to purchase participations from Penn Square and other lenders. Some fifty other banks across the country bought oil and gas participations from Penn Square. For example, Chase Manhattan Bank purchased some $212 million worth of participations. *See Chase Manhattan Bank, N.A. v. FDIC*, 554 F. Supp. 251 (W.D. Okl. 1983). Continental's participations ultimately totaled some $1.075 billion.

Continental began participating in Penn Square loans in 1978, including loans made to Eagle. Generally, each of Continental's participations was evidenced by two documents: a loan participation agreement and a certificate of participation. The loan participation agreements specifically provided that Penn Square would not, without

Continental's prior written approval, release the letters of credit that secured the drilling loans.

Contrary to the terms of the loan participation agreements with Continental, the certificate of participation prepared by Penn Square stated that Penn Square could release collateral and substitute new collateral without Continental's consent.

In February 1981, Eagle sent a Continental loan officer a package of Eagle offering materials, including a twenty-six page "Investment Brief" prepared by Investment Search, Inc. Page nine of the report, summarizing Eagle Drilling Partnership 1981's "strengths," stated that Eagle had returned letters of credit to limited partners before the expiration date in five of its fourteen private oil and gas partnerships. According to the report, this record indicated Eagle's ability to select prospects that generated revenues sufficient to obtain production loans. The record does not indicate that anyone at Continental read the report or this portion of it.

Later in 1981 there were signs within Continental of problems with the Penn Square participations. In the summer of 1981, Kathleen Kenefick, a Continental vice-president, wrote a memo about her concerns with the participations, including Continental's practice of lending money to Penn Square for 30 to 90 days before doing a credit analysis. Both John Lytle, who headed Continental's Mid-Continent division, which was in charge of Penn Square participations, and George Baker, a Continental executive vice-president who headed General Banking Services, of which Lytle's Mid-Continent division was a part, knew about the memorandum.

Baker became concerned with the level of Penn Square participations after reading the Kenefick memorandum. Baker told Gerald Bergman, who headed a special industries unit that included the Mid-Continent division, to discontinue purchasing participations in drilling fund loans supported by letters of credit and to convert the participations already purchased into direct loans. A Report of the Special Litigation Committee of the Board of Directors of Continental Illinois Corporation (the *Tone Report*) later stated that despite these directions, the "vast bulk of the participations were purchased, increased, or renewed after Baker's order was given."

In November 1981, two oil and gas engineers employed in the Mid-Continent division informed John Redding, a senior vice-president at Continental and Lytle's direct superior, that lending on Penn Square loans exceeded what oil and gas reserve evaluations indicated were justified. Redding apparently took no action with this information. One Continental engineer who questioned the wisdom of drilling fund loans was repeatedly told that letter-of-credit loans were "lucrative."

In December 1981, an audit revealed that Penn Square had made a series of personal loans to Lytle in the amount of $565,000 at preferential interest rates. After numerous consultations with Lytle's superiors, Roger Anderson, Continental's chairman, imposed monetary sanctions against Lytle but did not discharge him. About the same time as this discovery, Continental increased Lytle's lending authority to $10 million.

As time went on, several of the Eagle drilling loans were converted to production loans, replacing limited

partners' letters of credit with oil and gas reserves as security interests. On July 5, 1982, Penn Square was taken over by the Federal Deposit Insurance Corporation. Eagle, Markle, and Stanhagen all eventually declared bankruptcy.

II.

Plaintiffs invested in nine of the seventeen oil and gas limited partnerships Eagle formed between 1979 and 1981. In general, plaintiffs were told before they invested, often by Markle or Stanhagen, that Eagle had a good track record in exploring for and producing oil and gas, that prior programs had received production loans, and that no letters of credit had been called.

Before investing, however, plaintiffs received offering materials that stated a warning on the cover page that "THESE SECURITIES INVOLVE A HIGH DEGREE OF RISK." The circular also warned that Eagle "may not be able to successfully conduct the activities contemplated," and that since "oil and gas exploration . . . is considered speculative, . . . no assurance can be given that all or any part of an investment . . . will be recovered." The circular also stated that "[d]ue to the unpredictability of oil and gas exploration and development, the results of previous operations can not be construed as indicative of the results that may be achieved by the Partnership." Each investor signed a suitability letter acknowledging the "speculative nature" and "high degree of risk" of the investment and verifying that he had "a sufficient net worth to sustain a loss of his entire investment in the Partnership in the event such loss should occur."

Continental bought participations in only five of the nine programs in which plaintiffs invested. Continental had no contact with the plaintiffs and made no statements to them before they invested in Eagle.

Plaintiffs lost their investments when Eagle and Penn Square failed. They brought this suit against Continental in 1984, alleging that Continental had knowingly assisted Eagle "in fabricating its 'never had a letter of credit called' track record." Plaintiffs' Brief at 6. In particular, plaintiffs allege that Markle and Stanhagen violated securities law by misrepresenting Eagle track records in two respects: (1) although Markle and Stanhagen accurately stated that production loans had been received in the earlier programs and letters of credit released, those statements were misleading because of the failure to disclose that the oil and gas reserves were in fact insufficient to warrant the production loans; and (2) while Markle and Stanhagen accurately told investors that Eagle had repurchased its first two programs, that statement was deceptive because it did not reveal that Eagle repurchased the programs because it had not found adequate reserves.

At trial, plaintiffs' banking expert, John Bricker, a professor of finance at Southern Methodist University in Dallas, Texas, testified that Continental's initial participations in the Penn Square loans were not prudent because Stanhagen and Markle did not have the experience and expertise to discover oil and gas in sufficient quantities to fully repay the principal and interest they had borrowed from Penn Square. An internal Continental memorandum dated December 26, 1978, indicates that Continental became interested in the Eagle programs only after a

well-known drilling contractor became connected with the Eagle programs.

Continental employees testified that Penn Square released letters of credit and made production loans without consulting with or informing Continental. Plaintiffs did not controvert this testimony; Bricker testified that he had seen no evidence of Continental's consent to Penn Square's release of letters of credit or grant of production loans.

Lytle did not testify about Continental's relationship with Eagle, invoking his Fifth Amendment privilege against self-incrimination. The jury was informed that Lytle, along with a senior vice president of Penn Square, had been convicted of felony crimes involving dishonesty.

Dennis Winget, a former Continental vice-president and Penn Square employee, testified that it was difficult to sell limited partnership interests in a drilling fund without a track record and that calling letters of credit would make it more difficult to sell such interests. Redding likewise testified that calls of letters of credit in drilling fund programs like Eagle's would signal an unsuccessful venture.

The district court submitted the case to the jury on four counts: (1) aiding and abetting a violation of Section 10 of the Securities Exchange Act of 1934 (15 U.S.C. § 78j) and Rule 10b-5 of the Securities and Exchange Commission; (2) conspiring to violate the securities laws; (3) knowingly participating in a breach of fiduciary duty; and (4) RICO (18 U.S.C. § 1962). The jury returned a

verdict against Continental on all four counts. On Continental's motion for judgment notwithstanding the verdict, the district court set aside the RICO count, finding that the alleged acts were contrary to Continental's policies and that Continental could not be held vicariously liable under RICO for the acts of its employees. The court denied the motion on the other counts and entered judgment against Continental, stating:

> While some of [Continental's] arguments [for setting aside the jury verdict] are particularly persuasive, such as the claim that plaintiffs did not prove justifiable reliance on the alleged misrepresentations, given the standard of review I must apply in this case regarding the motion for judgment notwithstanding the verdict, I should not substitute my judgment for that of the jury. While I would come to different conclusions than the jury came to, I cannot say as a matter of law that the conclusions I would reach are the only reasonable conclusions.

Memorandum Opinion at 48.

In its verdict, the jury awarded damages of approximately $438,000 to plaintiffs on each count. Post-verdict juror affidavits stated that during deliberations the jury had "divided the total damage amount by four" and thus apportioned the damages "equally among the four different theories of recovery." Concluding that the affidavits rather than the actual verdict reflected the jurors' true intentions, the court amended the verdict to multiply the jury's award by four.

III.

The plaintiffs' position was summarized by the district court:

> [P]laintiffs contended that Penn Square and Continental helped Markle, Stanhagen and Eagle engage in a "pyramid" scheme. As long as the banks would make production loans, oil and gas promoters could sell their securities regardless of the sufficiency of the oil and gas used to collateralize the production loans. The benefit to the banks would be large interest bearing loans, and, despite the failure due to lack of oil and gas reserves of certain production loans, if enough loans were made the profits to the banks would exceed any losses which might occasionally occur. As long as the banks would make production loans, Markle, Stanhagen and Eagle had a good "track record" to point to in order to induce others to invest.

Memorandum Opinion at 8-9.

Continental challenges the judgment on the grounds that the district court incorrectly applied the law of secondary liability and that the evidence was insufficient to support the jury's verdict.

We review the district court's application of the law *de novo*. *Garionis v. Newton*, 827 F.2d 306, 309 (8th Cir. 1987). In deciding whether Continental is entitled to judgment notwithstanding the verdict,

> we must consider the evidence in the light most favorable to [plaintiffs], assume all conflicts in the evidence were resolved by the jury in [plaintiffs'] favor, assume [plaintiffs] proved all facts

> [their] evidence tends to prove, and give [plaintiffs] the benefit of all favorable inferences that may reasonably be drawn from the proven facts. A judgment notwithstanding the verdict "should be granted only when all the evidence points one way and is susceptible of no reasonable inferences sustaining [plaintiffs'] position.

Frieze v. Boatmen's Bank of Belton, No. 91-1030, slip op. at 3 (8th Cir. Dec. 2, 1991) (quoting *Washburn v. Kansas City Life Ins. Co.*, 831 F.2d 1404, 1407 (8th Cir. 1987)) (citation omitted). *See also Caudill v. Farmland Indus.*, 919 F.2d 83, 86 (8th Cir. 1990). Continental cannot prevail on its motion "if the evidence so viewed would allow reasonable jurors to differ as to the conclusion that could be drawn." *Cole v. Control Data Corp.*, No. 90-2685, slip op. at 3 (8th Cir. Oct. 16, 1991). For similar formulations of the standard of review to be applied to motions for judgment notwithstanding the verdict, *see, e.g., Nelson v. Production Credit Ass'n*, 930 F.2d 599 (8th Cir.), *cert. denied*, ___ S. Ct. ___ (1991); *Morgan v. Arkansas Gazette*, 897 F.2d 945 (8th Cir. 1990); *Gilkerson v. Toastmaster, Inc.*, 770 F.2d 133 (8th Cir. 1985); *Dace v. ACF Indus., Inc.*, 722 F.2d 374 (8th Cir. 1983).

A. Aiding and Abetting Liability

The three theories of secondary liability under which the district court submitted the case to the jury have similar elements under federal common law. Because the elements of aiding and abetting liability are also the core elements of the other theories, we will examine that theory first.

We evaluate a claim for aiding and abetting a violation of the securities laws under a three-part test:

(1) the existence of a securities law violation by the primary party (as opposed to the aiding and abetting party);

(2) "knowledge" of the violation on the part of the aider and abettor; and

(3) "substantial assistance" by the aider and abettor in the achievement of the primary violation.

FDIC v. First Interstate Bank of Des Moines, N.A., 885 F.2d 423, 429 (8th Cir. 1989). Continental's arguments on appeal assume that Eagle's actions defrauded plaintiffs. Therefore, we examine Continental's liability for aiding and abetting under the assumption that Eagle is primarily liable to plaintiffs for securities law violations.

As for the second element, that of whether or not Continental had "knowledge" of Eagle's primary violation, Continental asserts that because it had no duty to disclose knowledge of a primary violation to the plaintiff investors, plaintiffs were required to but failed to prove that Continental had actual knowledge of the primary violation, here Eagle's fraud.[3] In *FDIC v. First Interstate Bank*, a case in which a bank also sought to defend itself against claims for aiding and abetting a primary violator's fraud, we held that a defendant's general awareness of its overall role in the primary violator's illegal scheme

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[3] The district court's Instruction No. 27 required the plaintiffs to "prove by a preponderance of the evidence that Continental Bank or its agent had actual knowledge that the track record of early programs was being falsely portrayed and that Eagle Petroleum Corporation, Wesley Markle or Terry Stanhagen were doing so knowingly and with intent to defraud."

is sufficient knowledge for aiding and abetting liability. *Id.* 885 F.2d at 429-31. Such knowledge may be proved by and inferred from circumstantial evidence, including facts available to the defendant's employees. *Id.* at 431; *Woods v. Barnett Bank of Fort Lauderdale*, 765 F.2d 1004, 1009 (11th Cir. 1985) "Knowledge may be shown by circumstantial evidence, or by reckless conduct, but the proof must demonstrate actual awareness of the party's role in the fraudulent scheme." *Woodward v. Metro Bank of Dallas*, 522 F.2d 84, 96 (5th Cir. 1975). If an illegal scheme exists and a bank's loan assists in that scheme, the bank's knowledge of the scheme is the crucial element that prevents it from suffering automatic liability for the conduct of insiders to whom it loaned the money. *Id.* at 96 (citing Ruder, *Multiple Defendants in Securities Law Fraud Cases: Aiding and Abetting, Conspiracy, In Pari Delicto, Indemnification, and Contribution*, 120 U. Pa. L. Rev. 597, 630-31 (1972). "A plaintiff's case against an aider, abetter, or conspirator may not rest on a bare inference that the defendant 'must have had' knowledge of the facts." *Schlifke v. SeaFirst Corp.*, 866 F.2d 935, 948 (7th Cir. 1989) (quoting *Barker v. Henderson, Franklin, Starnes & Holt*, 797 F.2d 490, 496-97 (7th Cir. 1986)).

In *First Interstate*, we held that the bank had recklessly ignored signs of its depositor's misappropriation of funds in favor of seeking potential profits from its involvement with the depositor. 885 F.2d at 432. Severe recklessness can satisfy the scienter requirement, at least where the alleged aider and abettor owes a duty to the defrauded party. *Woods*, 765 F.2d at 1010.

> Severe recklessness is limited to those highly unreasonable omissions or misrepresentations

> that involve not merely simple or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and that present a danger of misleading buyers or sellers which is either known to the defendant or is so obvious that the defendant must have been aware of it.

Id. at 1010 (quoting *Broad v. Rockwell Int'l Corp.*, 642 F.2d 929, 961-62 (5th Cir.) (en banc), *cert. denied*, 454 U.S. 965 (1981)). In *Woods*, the court affirmed the imposition of aiding and abetting liability based upon a bank officer's letter of recommendation written solely for the purpose of currying favor with the bank's clients. The letter contained statements that the officer had no knowledge of, even though he was aware that the recipient would rely on the letter.

In *First Interstate*, the defendant bank had a statutory duty to disclose information to regulatory authorities when it knew or suspected that a depositor was using the bank to carry on an illegal scheme. *Id.* at 433. In *Metge v. Baehler*, 762 F.2d 621 (8th Cir. 1985), *cert. denied*, 474 U.S. 1057 (1986), we quoted *Woodward*, 522 F.2d at 97, for the proposition that "[w]hen it is impossible to find any duty of disclosure, an alleged aider-abettor should be found liable only if scienter of the high 'conscious intent' variety can be proved. Where some special duty of disclosure exists, then liability should be possible with a lesser degree of scienter." *Id.* at 625.

Whether or not the existence of a duty to disclose affects the level of knowledge required to establish aiding and abetting, the record does not establish that Continental had any duty of disclosure here. There is no evidence

that Continental, in its dealings with Eagle or Penn Square, undertook to communicate or disseminate information to the plaintiffs with an intent or awareness that plaintiffs would use it in the purchase or sale of a security.

Moreover, the record is deficient of probative evidence that Continental had even a general awareness of an Eagle or Penn Square illegal scheme. Plaintiffs place significance on the testimony of former Continental employees who were aware that calling letters of credit in oil and gas programs such as Eagle's was important for attracting investors to future programs. This is no indication, however, that Continental knew that Eagle was promoting a false track record. Continental's bare receipt of the Investment Search Report summarizing Eagle's programs does not establish that Continental knew that Eagle was misrepresenting its track record, especially because there is no evidence that Continental knew anything about the reserve levels of the production loans referred to in the report.

In addition, the record contains no evidence from which reasonable jurors could find that Continental had an interest in assisting Eagle or Penn Square in producing a false track record. In *Metge*, we reversed the district court's summary judgment, finding that "although the record is not very illuminating on the question of [the defendant's] benefit from IEI's delayed bankruptcy, we find sufficient evidence at least to give rise to an inference that [the defendant] may have benefitted at the expense of the certificate holders from IEI's renewed lease on life." 762 F.2d at 629. Thus, we found that the

facts presented a jury question on aiding-and-abetting liability. *Id.* at 630.

Here, however, the plaintiffs did not produce evidence at trial establishing that the interest Continental received on letter-of-credit loans would outweigh Eagle's occasional production loan default, or that anyone at Continental thought this would be possible. The testimony of Continental's employees that letter-of-credit loans were "lucrative" explains Continental's willingness to participate in Penn Square's loans, but it is not enough to support an inference that Continental knew of a scheme by Eagle to defraud.

What the record does show is that Continental's management at the time of the Penn Square participations was plagued with problems that permitted the poor judgment of some employees to prevent it from perceiving the risk of its involvement with Penn Square. As the district court stated, "[T]here is no question but that certain employees of Continental were negligent," a statement fully supported by the testimony at trial and by the findings included in the *Tone Report*.

The record shows that Lytle pursued an aggressive and risky lending policy that his superiors failed to adequately supervise. Baker's directions in late 1981 to discontinue letter-of-credit loans participations were not carried out, due to lack of supervision, and, perhaps, according to the record, misunderstanding. Lytle's personal debt to Penn Square bank constituted an unethical conflict of interest that may well have clouded his judgment, but it is an insufficient basis for a finding that

Continental agreed to assist Penn Square and Eagle in creating a false track record to attract investors.

Furthermore, whether the production loans Continental participated in were insufficiently supported by oil and gas reserves is not a matter of mathematical precision. Plaintiffs' banking expert testified that determining the prudent loan value of a given reserve is a matter of judgment without a fixed standard in the banking industry. Moreover, the record does not disclose that plaintiffs were aware of guidelines that Continental and Penn Square used in making loans. Thus, plaintiffs could not have known what reserves the banks considered adequate for granting a production loan.

The district court permitted the jury to find that Penn Square acted as Continental's agent, thus allowing the jury to attribute Penn Square's knowledge and actions concerning the Eagle loans. The record lacks evidence that would enable a reasonable jury to make such a finding. Although the certificates of participation allowed Penn Square to substitute collateral and thus grant production loans without Continental's consent, they were in conflict with the loan participation agreements on that point. There was no other evidence that Continental authorized Penn Square to act for it, that Penn Square accepted such an undertaking, or that Continental had any control over Penn Square or its actions concerning Eagle.

A bank may be willing to take a chance on a new and potentially valuable customer who does not meet its normal credit requirements. Although it is true that "if the

method or transaction is atypical or lacks business justification, it may be possible to infer the knowledge necessary for aiding and abetting liability," *Woodward*, 522 F.2d at 97, the evidence here made plain that letters-of-credit and production loan participations were hardly an atypical practice for banks in the late 1970s and early 1980s. Indeed, the profitability of such loans, by itself, is an obvious and legitimate business justification.

In *Metge*, we noted that otherwise unremarkable events viewed together may suggest an unusual pattern of events intimating an illegal scheme. 762 F.2d at 626. Speculative investments, however, are not enough to hold a private enterprise liable to others. Accordingly, we conclude that plaintiffs failed to produce evidence from which it could reasonably be found that Continental knew of any scheme to aid Eagle in falsely portraying its track record to investors.

The third element of aiding and abetting liability is substantial assistance in the achievement of the primary violation. Establishing this element also requires the plaintiff to show that the secondary party proximately caused the violation, or, in other words, that the encouragement or assistance was a substantial factor in causing the tort. *Metge*, 762 F.2d at 624.

Continental asserts that its business dealings with Penn Square were nothing more than routine business transactions and thus could not have constituted substantial assistance. In *Metge* and *First Interstate* we held that a party's involvement in only routine business transactions will not necessarily protect it from aiding and abetting liability. We need not decide whether there were more

than routine business transactions involved here, however, because we conclude that there is no evidence that Continental's actions proximately caused plaintiffs' loss. The thrust of plaintiffs' claim is that had they known the facts concerning Eagle's fabricated track record, they would not have invested in the Eagle partnerships. Plaintiffs' bare allegations, however, are not sufficient to support a finding that they were entitled to rely on Continental's participation in production loans as representations on which to base their investment decisions in the light of the knowledge plaintiffs had at the time they made their investments. When plaintiffs chose to invest in Eagle partnerships, they chose to subject themselves to the risks made explicit by the warnings and disclaimers contained in the Eagle offering materials. When Continental chose to participate in Penn Square loans, it evaluated other entities to determine its own course of conduct and did not guarantee its conclusions to the world at large. "Mindful of the potentially devastating impact aiding and abetting liability might have on commercial relationships," *Woods*, 765 F.2d at 1009 (citations omitted), we will not uphold aiding and abetting liability in a relationship between investor and lending bank as attenuated as that between plaintiffs and Continental without more evidence than we have here.

B. Other Secondary Liability Theories

The jury also returned verdicts in favor of plaintiffs for conspiracy to violate the securities laws and knowing participation in a breach of fiduciary duty. Knowing participation in a breach of fiduciary duty "is analogous to a cause of action . . . for aiding and abetting a securities

fraud," where the primary violation involves a breach of fiduciary duty. *Whitney v. Citibank, N.A.*, 782 F.2d 1106, 1115 (2d Cir. 1986). Likewise, liability for civil conspiracy is in substance the same thing as aiding and abetting liability. Civil conspiracy requires an agreement to participate in an unlawful activity and an overt act that causes injury, so it "do[es] not set forth an independent cause of action" but rather is "sustainable only after an underlying tort claim has been established." *McCarthy v. Kleindienst*, 741 F.2d 1406, 1413 n.7 (D.C. Cir. 1984); *accord Mizokami Bros. v. Mobay Chem. Corp.*, 660 F.2d 712, 718 n.8 (8th Cir. 1981); *Rotermund v. United States Steel Corp.*, 474 F.2d 1139, 1145 (8th Cir. 1973).

Thus, all three theories of secondary liability here rise or fall together. Because Continental is not liable for aiding and abetting securities fraud, it did not assist in breaching any fiduciary duty Eagle or Penn Square owed to plaintiffs. Likewise, Continental may not be held liable on the civil conspiracy claim because plaintiffs did not prove a substantive violation, much less an agreement to participate in one of the substantive offenses. Therefore, we find that Continental is not secondarily liable to plaintiffs under any of these theories.

D. [sic] Conclusion

We reverse that part of the judgment imposing secondary liability on Continental. As a result, we need not examine the damages issue. We affirm the judgment notwithstanding the verdict on plaintiffs' RICO claim on the

basis of the district court's thorough memorandum opinion.

A true copy.

Attest:

CLERK, U. S. COURT OF APPEALS,
EIGHTH CIRCUIT.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

K & S PARTNERSHIP, et al.,	)	CV 84-0-626
Plaintiffs,	)	
	)	**MEMORANDUM**
vs.	)	**AND ORDER**
	)	
CONTINENTAL BANK, N.A., etc.	)	(Filed Sep. 18, 1989)
Defendant.	)	

Continental Bank, N.A. ("Continental") moves for judgment notwithstanding the jury verdict (filing 298). The plaintiffs move for attorneys' fees (filing 297) on the basis that they recovered pursuant to a jury verdict on a civil RICO claim, and thus are entitled to attorneys' fees. Since I will grant, in part, the motion for judgment notwithstanding the verdict as that motion regards plaintiffs' recovery on the RICO claim, I will deny the plaintiffs' motion for attorneys' fees as moot.

This case involved an alleged securities fraud. Plaintiffs contended that Continental assisted certain promoters in oil and gas limited partnerships in creating a false track record, thereby luring the plaintiff investors into investing with the promoters of the oil and gas limited partnerships. The jury returned a verdict in favor of all plaintiffs against Continental on all counts of the complaint, including a RICO count.

I. J.N.O.V.

A. Introduction

Continental claims the jury verdict should be overturned because:

(1) Plaintiffs failed to prove their damages;

(2) Continental cannot be held vicariously liable for alleged acts of its employees under RICO;

(3) Plaintiffs failed to demonstrate a multiple scheme necessary to support a RICO claim;

(4) Plaintiffs failed to establish transaction causation or proximate cause;

(5) Plaintiffs did not justifiably rely on the alleged misrepresentations.

Continental's motion will be granted in part regarding the RICO claim, because on the trial record as a matter of law Continental did not directly violate the law, and the acts of its employees or agents cannot be imputed to Continental since it was not the corporate policy of Continental to seek "loan growth at any price." Otherwise, the motion for judgment notwithstanding the verdict should be denied.

B. Standard of Review

In deciding whether to grant the motion for judgment notwithstanding the verdict, the court, sensitive to the constitutional right to trial by jury, may grant the motion only when, without weighing the credibility of the evidence, there can be but one reasonable conclusion

as to the proper judgment. 5A J. Moore & J. Lucas, *Moore's Federal Practice* ¶ 50.07[2] (2nd ed. 1989). In considering the motion, the court must view the evidence in the light and with all reasonable inferences most favorable to the party who secured the verdict. *Id.* I have followed these principles in this case.

C. Failure to Move for Directed Verdict

Federal Rule of Civil Procedure 50(b) has been construed to require that a party who moves for judgment notwithstanding the verdict must have also moved for a directed verdict at the close of all of the evidence. This means that normally when a defendant, after moving for a directed verdict at the conclusion of plaintiffs' case, fails to renew the motion at the close of all of the evidence, defendant is deemed to have waived the defendant's right to judgment notwithstanding the verdict. *Meyers v. Norfolk Livestock Market, Inc.*, 696 F.2d 555, 558 (8th Cir. 1982). However, in some circumstances, the courts have excused noncompliance with this requirement. *Id.* (citing, among other cases, *Ohio-Sealy Mattress Mfg. Co. v. Sealy, Inc.*, 585 F.2d 821, 825 (7th Cir. 1978), *cert. denied*, 440 U.S. 930 (1979)). This is a case where noncompliance with the normal requirement should be excused.

Immediately before counsel argued the case to the jury, certain "housekeeping" matters were taken up outside the presence of the jury. Plaintiff had rested, but defendant had not done so formally.

The defendant offered certain exhibits, the court dealt with the offer, and defendant, although still not

formally resting, renewed a previous motion for directed verdict saying: "The only thing further is that we would – prior to the jury coming back in, would renew our motion for directed verdict." Plaintiffs then offered a chart so the chart could be used by plaintiffs in their counsels' argument before the jury. The chart was received. At that point the jury was brought back into the courtroom.

Counsel for the defendant then read a summary of tax deductions taken by individual plaintiffs arising out of their investments in the securities at issue. Essentially, what took place in front of the jury was the publication of a summary of previously admitted evidence. Defendant rested. Defendant did not renew the motion for directed verdict in front of the jury. Plaintiff offered no rebuttal. Closing argument began.

Essentially, what took place after defendant renewed its motion for directed verdict was (1) outside of the presence of the jury plaintiffs offered a chart so it could be used in argument by plaintiffs in front of the jury, and (2) defendant read into the record without objection and before the jury a summary of certain tax deductions taken by the plaintiffs and with which the parties had spent a considerable period of time dealing during the trial as each plaintiff testified.

I firmly understood, and I believe that all counsel did also, that the procedure used by defendant to summarize the tax return information was intended only to publish in the most expedient and least time consuming manner complex evidence essentially already in the record. I had ruled that the tax returns themselves would not go to the

jury. Although I did not explicitly tell counsel for defendant that he need not renew the motion after his summary of the tax return information, that was certainly my understanding and apparently defense counsel's as well. I was not in any way misled by the actions taken by the defendant, and plaintiffs likewise make no claim that they were misled.

There are two purposes for the requirement that one must move for a directed verdict at the close of all of the evidence in order later to be permitted to move for judgment notwithstanding the verdict. 5A J. Moore & J. Lucas, *supra*, ¶ 50.08. The first purpose is to ensure that the court examines the sufficiency of all of the evidence as a matter of law before the jury renders its judgment on the facts, so that the constitutional right to a jury trial on the facts is preserved. *Id.* In other words, the right to a jury trial should not be denied until the court knows all of the evidence and can state as a matter of law that the evidence is insufficient. The less esoteric, and more practical, reason for the rule is to avoid trapping the unwary; that is, at the time the motion for directed verdict is made the party against whom the motion is made can still cure the alleged deficiency. *Id.* Thus, the rule seeks to promote justice and the avoidance of tactical victories at the expense of justice.

In this case, since no one was misled or prejudiced, the court tacitly condoned the procedure, no new evidence was presented, and the evidence presented was brief, the failure to renew the motion for directed verdict is not fatal. *Halsell v. Kimberly-Clark*, 683 F.2d 285, 294 (8th Cir. 1982), *cert. denied*, 459 U.S. 1205 (1983); *Ohio-Sealy Mattress Mfg. Co.*, 585 F.2d at 824-26; *Pittsburg-Des Moines*

Steel v. Brookhaven Manor Water Co., 532 F.2d 572, 576 (7th Cir. 1976); 5A J. Moore & J. Lucas, *supra*, ¶ 50.08.

D. Vicarious Liability Under RICO

Continental argues that the evidence as a matter of law failed to establish any reasonable inference that the alleged wrongful acts of its employees, or those acting in union with those employees, became the policy of Continental. If it was not the corporate policy of Continental to further the alleged wrongful acts of its employees, and those acting in concert with its employees, then Continental argues that as a matter of law it cannot be held vicariously liable under RICO. I agree.

This case was at its core a securities fraud case. Among other things, the plaintiffs contended that Eagle Petroleum Corporation ("Eagle"), Wesley Markle and Terry Stanhagen created a false track record of success with regard to limited partnerships, which had been formed to explore for oil and gas, by two means: (1) Eagle, Markle and Stanhagen created a false track record of success by representing that drilling loans obtained in earlier programs had been replaced by production loans when at the same time those production loans were based upon insufficient oil and gas reserves to justify the loans; and (2) Eagle, Markle and Stanhagen misrepresented their track record by concealing the fact that two of its earlier programs, Kingfisher and Equity, had not found sufficient quantities of oil and gas to be successful and those programs were "repurchased" from the investors without disclosure of those facts to later investors (Filing 276, Instruction 24).

At the heart of this case were a series of banking transactions spanning a number of years between Continental and Penn Square Bank ("Penn Square"). Plaintiffs sought to prove a conspiracy whereby Continental and Penn Square entered into an unlawful agreement to defraud plaintiffs and other investors in syndicated oil and gas programs by facilitating the sale of Eagle securities, or other securities of other syndicated deals, by creating a false track record respecting the past performance of the oil and gas syndicator (Filing 276, Instruction 32). Plaintiffs sought also to prove that Continental substantially assisted Eagle, Markle and Stanhagen in the sale of securities by participating in the making of production loans (Filing 276, Instruction 28).

First, it was claimed that Penn Square would make a "drilling" loan to the Eagle partnerships, and other oil and gas promoters (secured by letters of credit furnished at the request of, and on behalf of, the investors by their personal bank (Filing 276, Instruction 32).[1] After Penn Square made the drilling fund loan, plaintiffs contended

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[1] A drilling loan was a loan made to finance the finding of oil and gas. If oil or gas was found in sufficient quantities, the drilling fund loan was replaced with a longer term loan, known as a production loan, which production loan was collateralized by the oil and gas reserves. Letters of credit would pay the drilling fund loan if the drilling fund loan was called by Penn Square in the event that no long term loan could be made to the oil and gas promoter because no oil and gas were found. If oil and gas were found, the letters of credit were normally released in favor of the long term production loan. In this way investors could make highly leveraged investments in oil and gas syndicated investments with little or no "up front" cash.

that Penn Square would then make a production loan to Eagle (or other oil and gas promoters) thereby causing the release of letters of credit, with Penn Square either: knowing that the petroleum reserves were insufficient to repay the production loan or recklessly disregarding the need to ascertain whether the petroleum reserves were sufficient to repay the production loan (Filing 276, Instruction 32).[2]

Continental's part in these transactions was said to be that of a "participant," meaning, under normal circumstances, that a large bank, like Continental, would purchase all or a portion of the production loan from Penn Square, which was a much smaller bank. However, plaintiffs contended that the circumstances were not normal. Plaintiffs contended that the "participation" of Continental was with knowledge that the oil and gas reserves were insufficient to pay the production loans, or that Continental recklessly disregarded the need to ascertain whether the reserves were sufficient.

In essence, plaintiffs contended that Penn Square and Continental helped Markle, Stanhagen and Eagle engage in a "pyramid" scheme. As long as the banks would make production loans, oil and gas promoters could sell their securities regardless of the sufficiency of the oil and gas used to collateralize the production loans. The benefit to

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[2] Once the production loans were made they were ostensibly collateralized by the oil and gas reserves. When a production loan was made the letter of credit would normally be returned and the investor was no longer at risk to have to pay the drilling fund loan which was refinanced by the production loan.

the banks would be large interest bearing loans, and, despite the failure due to lack of oil and gas reserves of certain production loans, if enough loans were made the profits to the banks would exceed any losses which might occasionally occur. As long as the banks would make production loans, Markle, Stanhagen and Eagle had a good "track record" to point to in order to induce others to invest. As long as investors had no cash in the limited partnership, as where letters of credit were used to finance the investment, if production loans were made, causing the release of the letters of credit, investors had nothing to lose and could make an investment sometimes without paying any money. Ultimately, Penn Square was closed by federal regulators, outstanding letters of credit were called because no one would make production loans, and these plaintiffs, along with others, sued.

Plaintiffs contended that Continental violated sections 1962(c) and (d) of RICO for essentially the same reasons that Continental was guilty of being an aider and abettor of the securities fraud of Markle, Stanhagen, and Eagle, and for essentially the same reason that Continental was a co-conspirator of Penn Square (Filing 276, Instructions 39 and 49). It is at this juncture that Continental makes a compelling argument – there was never any evidence from which a jury could reasonably infer that Continental adopted as a matter of policy the acts of its employees in dealing with Penn Square. Accordingly, Continental argues that the RICO judgment must be overturned.[3]

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[3] At oral argument Continental agreed that plaintiffs could prove a civil securities fraud conspiracy or a civil aiding and

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(1) Theory

The cases make clear that before RICO liability may be imposed it must be proven that it was the corporate policy which created the scheme or senior corporate management which implemented the scheme. *See, e.g., D & S Auto Parts, Inc. v. Schwartz*, 838 F.2d 964, 966-68 (7th Cir.), *cert. denied*, 108 S. Ct. 2833 (1988); *Schofield v. First Commodity Corp.*, 793 F.2d 28, 32-33 (1st Cir. 1986); *Gruber v. Prudential-Bache Sec., Inc.*, 679 F. Supp. 165, 181 (D. Conn. 1987); *O'Brien v. Dean Witter Reynolds, Inc.*, Fed. Sec. L. Rep. (CCH) ¶ 91,509, at ___ (D. Ariz. Mar. 26, 1984) (LEXIS, Fedsec library, Courts file); *Dakis v. Chapman*, 574 F. Supp. 757, 759-60 (N.D. Cal. 1983). It is important to understand that the policies behind vicarious liability and RICO are different. In the normal civil context, vicarious liability is used to shift the economic costs of the

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abetting a primary securities fraud violation on the part of a corporation without establishing that the corporate policy of the defendant was to commit the fraud. In other words, Continental argued that there was a level of "knowledge" or "scienter" required in proof of a RICO claim which was not required in proof of the other claims. Continental contends that proof of a RICO claim requires evidence of a "knowing and intentional participation in the criminal scheme at a level at which it can be said that the criminal activity constitutes corporate policy." Memorandum of Law in Support of Defendant's Motion for Judgment Notwithstanding the Verdict at 19 (footnote omitted). Accordingly, Continental conceded at oral argument that a finding for it on the motion for judgment notwithstanding the verdict regarding the RICO claim would not as a consequence require a finding for it on the motion for judgment notwithstanding the verdict on the other claims.

damage from the innocent third party to the producer of the product in order that the producer internalizes the costs, passes those costs along to the consumer, and thereby is placed in a competetive [sic] disadvantage when competing against others who produce better quality goods at lower costs. In such a situation a corporation has an incentive to lower its costs by dealing more effectively with its employees. The intent of RICO, however, is to force the corrupt business from the marketplace altogether. Thus, it makes little sense to impose RICO treble damage liability upon an otherwise legitimate entity unless it is shown that the corporate policy was to violate RICO in the first case. Thus it has been said that:

> Imposition of liability following direct corporate responsibility for the predicate acts and the RICO violation is also consistent with the policies behind the RICO statute. The corporation with direct responsibility can be penalized for its predicate violations and forced to compensate the injured parties for the harms it caused. Under the RICO statute, the corporation can be undercut financially through forfeitures and treble damages or directly enjoined from further business practice. Such penalties are appropriate to a corporation conducting a business enterprise through a pattern of racketeering activity.
>
> Holding a corporation vicariously liable for the commission of predicate acts by its employees advances the policies behind vicarious liability, but is inconsistent with the goals of civil RICO. Under vicarious liability, the corporation, although not directly responsible for

> the harmful acts, is forced to compensate innocent third parties. It internalizes the costs of its employees' misdeeds as a cost of doing business and passes the expense along to the public in the price of its product or service. The corporation is encouraged to deter future violations and to reduce these costs, thereby reducing the cost of its product and gaining a market advantage. In contrast, civil RICO was designed to wage economic war on organized crime. Its remedies, notably forfeiture and treble damages, *were intended to force the corrupt business from the marketplace. Even its civil remedies were designed not merely to compensate, but to enlist private aid in the attack on organized crime.*

Note, *Judicial Efforts to Redirect an Errant Statute: Civil RICO and the Misapplication of Vicarious Corporate Liability,* 65 B.U.L. Rev. 561, 602 (1985) (footnotes omitted) (emphasis added).

The United States Court of Appeals for the Eighth Circuit has recognized in the RICO context that something more than evidence sufficient to prove vicarious liability is required to prove a RICO claim. *Luthi v. Tonka Corp.*, 815 F.2d 1229, 1230 (8th Cir. 1987). In *Luthi*, plaintiffs' contended that Tonka should be held liable because its chief financial officer caused plaintiffs' financial loss by fraudulent acts relating to a purchase of various corporations owned by plaintiffs. Liability was asserted under 18 U.S.C. § 1962(c) of RICO. *Id.* at 1229.

Mr. and Mrs. Luthi owned the stock of two corporations, which I shall call A and B. They sold their stock in A and B to a corporation I shall call C. The sale was for a relatively small amount of cash up front, with a note for

the balance. Prior to the purchase of the stock, Tonka had invested in a corporation which I shall call Corporation D. That investment was made at the direction of the chief financial officer of Tonka. Corporation D controlled Corporation C and both those corporations were in turn controlled by Tonka and its chief financial officer. Corporation C had been established solely for the purpose of acquiring the stock of Corporations A and B. *Id.*

Mr. and Mrs. Luthi brought suit after Corporation C defaulted. They asserted a claim against Tonka exclusively under RICO. After a pretrial dispositive motion had been granted, Judge Bright wrote the panel opinion which concluded that RICO did not apply because the doctrine of respondeat superior – one who is not at fault may be held vicariously liable for the wrongdoings of another – is contrary to the purposes of RICO. *Id.* at 1229. Accordingly, the court concluded that the trial court properly dismissed the complaint of Mr. and Mrs. Luthi. *Id.* at 1230.

While *Luthi* may be read by plaintiffs and defendant in this case in slightly different ways, what is absolutely clear about *Luthi* is that *something more than vicarious liability must exist to charge a corporation with the acts of its employees under 18 U.S.C. § 1962(c) of RICO.*[4]

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[4] Plaintiffs also sued under a RICO conspiracy theory alleging a conspiracy to violate 18 U.S.C. § 1962(d). There seems no doubt that if something more than a vicarious liability doctrine is necessary to charge a corporation under

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Plaintiffs in their brief essentially concede the point that something more than vicarious liability is required to impose RICO liability. Plaintiffs argue in their brief:

> Unlike *Luthi*, the Plaintiffs in this case did not seek damages *solely* on the basis of vicarious liability. The Plaintiffs sought and introduced evidence from which the jury could reasonably conclude that Lytle and other Continental employees served the corporate policies of Continental in transacting business with Penn Square Bank. *The evidence introduced at trial overwhelmingly supported the conclusion that John Lytle's conduct furthered the corporate policy goals of Continental.*

Plaintiffs' Memorandum of Law In Opposition to Defendant's Motion For Judgment Notwithstanding the Verdict at 14 (emphasis added).

It is precisely because the evidence at trial establishes as a matter of law that the activities of Continental's employees *did not* further the corporate policy *goals* of Continental that judgment notwithstanding the verdict must be granted on the RICO claim.

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§ 1962(c), then the same standard applies to § 1962(d). Plaintiffs do not contend otherwise. This is not necessarily true under § 1962(a). *Cf. Liquid Air Corp. v. Rogers*, 834 F.2d 1297, 1306-07 (7th Cir. 1987). Among other things, § 1962(a) prohibits a person from investing monies received from a pattern of racketeering activity in an "enterprise" engaged in interstate commerce. This is not a § 1962(a) case.

(2) The "Tone Report"

The failure of Penn Square touched off one of the most significant banking failures in the history of this country. In effect, Penn Square, a relatively small Oklahoma bank, caused, or substantially contributed to, the failure of Continental, a large international money center bank.

As a result of the collapse of Penn Square and the impact upon Continental of Penn Square's failure, various stockholder suits were filed against Continental. As a consequence of these suits, the board of directors of Continental created what became known as the "Tone committee." This committee prepared what became known as the "Tone report" officially known as the Report of the Special Litigation Committee of the Board of Directors of Continental Illinois Corporation (Exhibit 90).

The "Tone report," prepared with the assistance of a former federal judge, sought to set forth the advice of a special litigation committee of the board of directors as to the position the board should take in the exercise of its fiduciary duty to stockholders regarding the pending derivative law suits. Over vigorous objection in this case by Continental, the "Tone report" was received in evidence in a redacted form. The "Tone report" is an objective, highly critical, analysis of the policies of Continental as well as the actions taken by employees of Continental when dealing with oil and gas credits.[5]

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[5] Plaintiffs described the Tone report as having "inherent trustworthiness." Memorandum in Opposition to Defendant's

(Continued on following page)

The "Tone report" (Exhibit 90), as well as the deposition testimony of former employees of Continental and Penn Square (Exhibits B through J) failed to establish as a matter of law that Continental or its senior management implemented a policy to increase the dollar volume of its loan portfolio even if that required a reduction in the quality of its loan portfolio. It was the contention of plaintiffs in this case that Continental engaged in a "loan growth at any price" policy. The evidence failed as a matter of law to establish that contention.

(3) The "Black Hats"

So as not to be misunderstood, there is no question but that certain employees of Continental were negligent. Indeed, in ringing terms, the special litigation committee of Continental deplored what happened at Penn Square, and found negligent the actions of three individuals who dealt with, or were otherwise responsible for loans regarding, Penn Square.

For example, the "Tone report" concluded that the relationship between Continental and Penn Square was negligently mishandled by Messrs. Lytle, Redding, and Bergman, who were employees of Continental. (Exhibit 90, 28-29). The Tone committee found:

> In general, there is substantial evidence that loans were disbursed without the approval of

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Motion in Limine at 17. Indeed, outside directors were dismissed as defendants as a result of the report. *In re Continental Ill. Sec. Litig.*, 732 F.2d 1302, 1304-06 (7th Cir. 1983).

officers having the requisite lending authority; that the creditworthiness of borrowers was not sufficiently checked; that loans secured by reserves were disbursed without confirmation by the Bank's engineers of the value of the reserves; that loans which could not be justified by proven reserves were approved through the use of additional types of collateral which were insufficient; that in a number of instances security interests were not perfected; that at periodic intervals, Lytle caused the Bank to purchase groups of Penn Square participations without proper credit investigation, to relieve Penn Square's recurrent "liquidity crunches"; that Lytle tolerated improper actions by Bill G. Patterson, Executive Vice President of Penn Square, such as filling out the Bank's CRF forms for a loan or deceiving a loan officer into believing that Lytle had approved a loan when he had not done so; that loans were disbursed without preparation of notesheets or furnishing of sufficient data to permit them to be rated; that there were severe problems of lack of loan and collateral documentation and past due payments in connection with Penn Square loans; that the past due notices and exception reports generated as a result of these deficiencies were largely ignored and, in any event, never cleared up by Lytle; and that Redding (whose office was adjacent to Lytle's) had knowledge of or at least warning about many of these matters and took no effective action to correct them.

(Exhibit 90, 28-29).

Specifically with regard to Mr. Lytle, the Tone committee report found:

> Mr. Lytle was the Vice President in charge of Mid-Continent Division during the period in which the Penn Square participations increased from $200 million to over $1 billion and personally was involved in the making and renewal of all or virtually all of these loans. He personally was responsible for what occurred in his Division with respect to Penn Square transactions. There is substantial evidence that would support a finding that the improper credit practices and failures to follow Bank procedures described in Section III, A, at pp. 27-29, *supra*, occurred and that Lytle was responsible for those practices and failures.
>
> The evidence in support of the claim of negligence against Mr. Lytle is clearly sufficient to go to the jury, and the Corporation's interest would be served by continued prosecution of that claim.

(Exhibit 90, 108-09).

With regard to Mr. Redding, the Tone committee specifically found:

> Mr. Redding, as Senior Vice President in charge of the Oil & Gas Group, was Mr. Lytle's immediate superior, located in an adjoining office throughout the Penn Square period. There is substantial evidence that would support the following findings:
>
> Mr. Redding apparently did not control Mr. Lytle's improper practices, despite his knowledge of many of them. He saw the large volume

of Five Day Rule exception reports and knew that Mr. Lytle was processing loans for which he needed but had not obtained Redding's approval. Nevertheless, Mr. Redding never took action to stop this practice of Mr. Lytle's. Instead, he contented himself with sending back notesheets he did not approve for further work and declining to place his initials on certain loans, even though he often found that "the money was already out the door." Although he told Mr. Lytle that he was too close to Penn Square, Mr. Redding took no action to correct the situation when Mr. Lytle ignored his warnings.

In addition to failing to supervise Mr. Lytle, Mr. Redding failed in his own credit approval duties. His signature and approval were necessary for the larger of the Penn Square loans, and he was familiar with the details of many of them. A number of these loans proved, upon examination in early July and subsequently, to have been of very poor quality. Mr. Redding did not protect the Bank from those loans of poor quality. Also, he failed to take action after the warnings by Ms. Kenefick and by the engineers. In addition, he failed to take action to see that the Bank's procedures as to loan documentation, collateral, and past dues were followed despite seeing a large volume of Penn Square Loans continually on exception reports.

Redding did not carry out the instructions Mr. Bergman says he gave Mr. Redding to switch the Penn Square participations to a direct loan basis. He did not even effectively accomplish the limited switch-over he admits to have undertaken.

> Redding says that he took comfort from the "relatively clean" reports of the internal auditors in the reports on the October and December 1981 audits of Penn Square. It is at least open to serious question whether these reports could reasonably be interpreted as "clean"; the auditors did not think so.
>
> Finally, when Mr. Lytle's personal loans were under investigation, Mr. Redding at first favored termination but later altered his recommendation and his memorandum on the subject at the request of his superiors. He never informed the group investigating the Lytle loans about and of the Penn Square problems. Instead, he joined with Mr. Bergman in assuring everyone that the Penn Square participations were of good credit quality.
>
> The evidence that Mr. Redding was negligent is clearly sufficient to go to the jury, and the claim against him should not be dismissed.

(Exhibit 90, 109-111).

And with regard to Mr. Bergman, the Tone committee found:

> Mr. Bergman was the Executive Vice President in charge of the Special Industries Department, which included the Oil & Gas Group. He was Mr. Redding's direct supervisor. Throughout the Penn Square period, however, his responsibilities included a number of groups and divisions in addition to the Oil & Gas Group. He was not as intimately acquainted with the operations of the Mid-Continent Division as Mr. Redding.

There is substantial evidence that would support a finding that Mr. Bergman was negligent in his supervisory role and in reporting to his superiors. Mr. Bergman received the Five Day exception reports and other exceptions reports relating to the Mid-Continent Division. It appears that he did not take any effective action to investigate the cause of Mid-Continent's large number of exceptions or to clear them up. Nevertheless, he repeatedly assured Messrs. Coriaci, Melick, Baker, and others present at weekly GBS management meetings that substantive problems with exceptions and past dues did not really exist and that the complaints were the result of inaccurate reporting by the GBS Operations department. On one occasion (in November, 1981), he also informed the Corporate Office that this was the fact. When Baker told Bergman that Ms. Kenefick criticized the way in which Lytle ran the Mid-Continent Division, Bergman simply dismissed the matter as a "personality conflict" between Mr. Lytle and Ms. Kenefick without asking for the details of the complaints or making any other investigation.

In September or October of 1981, Mr. Baker became concerned when both Mr. Bergman and Mr. Redding demonstrated their lack of familiarity with Penn Square commitments by estimating the level of participations at approximately 50% of the actual number. Mr. Bergman then reassured Mr. Baker that the Penn Square loans were checked as carefully as if they were direct loans. It does not appear that he had a basis for this assurance. Although Mr. Bergman's accounts vary, he admits to receiving orders from Mr. Baker (or agreeing with him)

that either all or at least the larger Penn Square loans should be changed to a direct basis. Yet, Mr. Bergman failed to see that this change was accomplished.

After the *American Banker* article on Penn Square appeared in April, 1982, Mr. Bergman gave further assurances to Mr. Baker concerning the conversion of Penn Square participations to direct loans and concerning the quality of all the transactions with Penn Square. Yet Mr. Bergman admits that in the interval between September and May, he neither asked for nor received any detailed reports from Mr. Redding concerning the conversation [sic] to direct loans. At most, he asked Mr. Redding how the matter was coming and received general assurances that it was progressing satisfactorily. In any event, it is not clear that almost none of the Penn Square loans were converted to direct loans by the Bank.

Mr. Bergman relied upon the Bank's internal audit reports on Penn Square, which he viewed as "relatively clean," as a basis for some of his later assurances. His view of these audit reports, however, is contrary to that of the auditors, and, in any event, he concedes that the reports did not purport to evaluate the creditworthiness of the Penn Square loans. Furthermore, although Mr. Bergman states that these audits were "routine" in nature, the auditors state that it is unusual for them to audit another bank in this fashion. The auditors also recall Mr. Bergman displaying a sense of urgency and suspicion about Penn Square operations at the time he sent them down to Penn Square.

Mr. Bergman went to Mr. Lytle's defense after Mr. Lytle's personal loans from Penn

> Square were disclosed. During the course of the deliberations regarding sanctions for Mr. Lytle, Mr. Bergman made no investigation of the Penn Square loans and said nothing about the problems with Penn Square; instead, he joined the other line officers in assuring the Chairman and others that the Penn Square loans were of good credit quality.
>
> It should be noted, in considering the claims against Mr. Bergman, that he was seriously ill from approximately December, 1981, until March, 1982. To his credit, at no time during the interviews did he assert his illness as an excuse. Also, he sent the auditors to Penn Square and gave orders for at least a limited switchover of Penn Square loans to a direct basis. Nevertheless, Mr. Bergman's apparent failure to supervise Mr. Redding and Mr. Lytle, and his repeated assurances that "all is well" when he had made little or no investigation, lead the Committee to conclude that there is sufficient evidence to support a finding of negligence against him and that the claim against him should not be dismissed.

(Exhibit 90, 111-14).

Based essentially on the foregoing, the plaintiffs contended that there was enough evidence for the jury to conclude that corporate employees were carrying out Continental policy because: The head of Continental's Mid-Continent division, John Lytle, was inadequately supervised, because Lytle was encouraged to buy participations from Penn Square, and because Continental did not fire Lytle when it found out that Lytle had borrowed more than one-half million dollars from Penn Square

while Lytle was doing business on behalf of Continental with Penn Square. Plaintiffs' Memorandum of Law in Opposition to Defendant's Motion For Judgment Notwithstanding the Verdict at 14-15. Recognizing the negligence of Lytle, Redding and Bergman, the evidence, in contrast, reveals that what went on at Continental with Mr. Lytle, Mr. Redding and Mr. Bergman was not in furtherance of corporate policy, but in direct counterventionof it. The following represents an objective analysis of the evidence presented to the jury which forces me to conclude that Lytle, Redding and Bergman were not following corporate policy and that senior management of Continental and Continental's board of directors cannot be charged with knowledge such that Continental can be charged with RICO liability.

(4) Personnel and Lending Hierarchy

General Banking Services ("GBS") was a division of Continental which engaged in wholesale domestic lending, except real estate (Exhibit 90, 14). GBS was headed by George R. Baker, who was an executive vice president and who reported directly to the chairman of the board, Roger E. Anderson. (Exhibit 90, 14-15). GBS was, in turn, divided into several lending departments (Exhibit 90, 15). One such unit was the special industries unit headed by Gerald K. Bergman, who reported to Baker. (Exhibit 90, 15). The special industries group was in turn divided into units, one of which was called the oil and gas group, headed by John A. Redding, who reported to Bergman. (Exhibit 90, 15). The oil and gas group was further subdivided into groups, one of which was the Mid-Continent

division headed by John Lytle, who reported to Redding. (Exhibit 90, 15).

To put the Mid-Continent division of which Lytle was responsible in perspective with GBS, of which Lytle's department was only a small part, it is helpful to understand that the Mid-Continent division's loans as a percentage of total GBS loans never exceeded, on an average basis, 15% of the average loans made by GBS. (Exhibit 90, 83). On an average basis, Mid-Continent's loans were 14% of GBS loans as of June 1982, up from 6.3% as of December of 1980. (Exhibit 90, 83). Although the dollar volume of Mid-Continent's loans were quite significant, Mid-Continent's loans were only a small part of the huge dollar volume of loans made by all of the operating units of Continental.

It is also helpful to understand that senior management and the board of directors of Continental were insulated from Lytle not only by the personnel hierarchy described above, but by the loan origination and review process. (Exhibit 90, 18-27). The senior management of Continental was known as the "corporate office." The loan origination and review process worked as follows.

When a loan, or a participation, was made by a lending officer supervised by Lytle, the officer was supposed to create two documents. One document was called an "approval notesheet" ("notesheet"), and the other document was called a "credit reporting form" ("CRF"). (Exhibit 90, 18-19). The notesheet described the lending officer's analysis of the credit, and the CRF provided the data necessary for Continental to open the credit facility for the borrower. (Exhibit 90, 18-19). Each loan officer had

a credit limit above which the officer could not approve a loan unless a person having adequate lending authority had given written approval for the credit. (Exhibit 90, 19). There was, however, a five-day rule which permitted the credit to be extended without written approval of the next higher authority provided that written approval was obtained in five days. (Exhibit 90, 19). It was then implicit that oral approval had been obtained. (Exhibit 90, 19).

The loan operations department of GBS was to collect the material supporting the loan and to maintain the documentation flow so that the lending officers could obtain missing approvals and documents. (Exhibit 90, 20). GBS loan operations prepared exception reports. One of the exception reports dealt with violations of the so-called five-day rule. (Exhibit 90, 20). These reports went to officers with the requisite lending authority (normally Redding for the Mid-Continent division) and to the head of the department (Bergman) and to Lytle. (Exhibit 90, 20-21). Even with an exception report, the borrower could still draw down on the credit. (Exhibit 90, 20). With respect to many Penn Square loans, Lytle never obtained the necessary approvals despite the exceptions. (Exhibit 90, 21). The Tone report found that Penn Square participations appeared on various exception reports prepared by GBS operations, but typically were not cleared up for extended periods of time, if ever. (Exhibit 90, 22).

After the loan was made, GBS loan review, which is separate from GBS loan operations, prepared data needed to "rate" loan quality. (Exhibit 90, 22). GBS loan review prepared a backup sheet for a separate entity known as loan administration. (Exhibit 90, 22). Loan administration rated loans. (Exhibit 90, 22-25).

Loan administration, separate from GBS altogether, but not part of the corporate office, would rate loans of $500,000 or more. (Exhibit 90, 23). The following scale was used: A = Prime; B = Satisfactory; C = More than normal risk; and D = Poor quality. (Exhibit 90, 23). Loans were to be rated or rerated annually. (Exhibit 90, 24). However, loan administration could not rate or rerate many credit files related to Penn Square, because GBS loan review could not prepare the necessary backup sheets because the necessary data was lacking. (Exhibit 90, 24).

Once again, back in GBS, there was a credit policy committee ("CPC") which included many heads of the departments within GBS, and which met weekly to monitor "C" and "D" rated loans to ensure that good lending practices were followed in GBS. (Exhibit 90, 25).

Loan administration, which once again is independent of GBS, collected information on problem loans and "C" and "D" rated loans and accordingly published a "watch list" for reporting to the corporate office and the board of directors. (Exhibit 90, 26). Essentially the "watch list" was to pull together the collective opinions of the lending officers, CPC and loan administration on problem loans so that the corporate office and the board could be advised. Significantly, no Penn Square loans were reported on the "watch list" until June of 1982 (Exhibit 90, 26-27). Penn Square failed on July 5, 1982. (Filing 276, Instruction 5).

(5) Corporate Office in the Dark

It is also clear that Continental, obviously not perfectly, followed a policy of critically evaluating its relationship with Penn Square. There is no evidence that the serious problems of Penn Square were ever communicated to the corporate office or the board of directors of Continental in such a manner that senior management or the board could be charged with having furthered or created a corporate policy to increase the dollar volume of its portfolio at the expense of portfolio quality. Clearly, there were "red flags" raised about what was happening at Penn Square, but no evidence suggests a fair inference that the corporate office or the board of directors promoted the "loan growth at any price" policy that plaintiffs say Lytle sought to advance. Some specific instances will serve to illustrate the point.

Beginning in 1981, the volume of Mid-Continent's "exceptions and past dues" was frequently discussed by GBS loan operations staff. (Exhibit 90, 29). Lytle claimed that the exception reports were riddled with errors. (Exhibit 90, 29-30). Apparently Lytle's view was not inaccurate, since the bank's management generally recognized that loan operations was troubled by an out-moded computer system. (Exhibit 90, 30). The part of the system that related to loan operations was not revamped until October 1, 1982. (Exhibit 90, 29-30). The persistent loan operation problems, according to the Tone committee, were in part the cause of the Penn Square-generated exceptions and "past dues" being dismissed at the meetings as "paperwork" problems. (Exhibit 90, 30).

The operations and lending side of GBS both underwent internal audits regarding their treatment of loan exception reports as of July 15, 1981. (Exhibit 90, 31). The audits concluded in January of 1982 that while the loan operations side was accurately reporting documentation exceptions, many of the lending divisions lacked formal procedures to ensure that exceptions were being cleared up properly. (Exhibit 90, 31). The auditors asked Baker to respond to the administrative office by February of 1982, but as of the date Penn Square failed no response had been submitted. (Exhibit 90, 31).

Nevertheless, loan operations at GBS were engaged in "audits" of Penn Square. (Exhibit 90, 31). The first visit was in December of 1981 and the second visit was in February of 1982. (Exhibit 90, 31).

The audit team issued a report that suggested further "work" was required at Penn Square and Continental including the implementation of an electronic mail terminal, new procedures for the processing of Penn Square related loans which mandated that funds could not be disbursed absent a properly approved CRF and notesheet, participation agreements and supporting documents were to be required before disbursement, and title opinions and mortgage filings for secured loans were to be required prior to disbursement. (Exhibit 90, 32). While these procedures were required, Mid-Continent apparently largely ignored these suggested procedures. (Exhibit 90, 32).

The head of the "audit team," while identifying various problems at Penn Square, wrote a report which was "optimistic, suggesting that progress had been made and

that the problems could be solved with additional effort." (Exhibit 90, 32).

Another "red flag" was a memorandum written by a young vice president named Kathleen Kenefick. (Exhibit 90, 33). Sometime in the summer of 1981 she prepared a memorandum. She essentially complained of a lack of control with regard to the loans being originated at Penn Square Bank. (Exhibit 90, 33). Kenefick discussed her concerns with Lytle and in fact showed him a draft of the memorandum. (Exhibit 90, 33). Baker obtained a copy of the Kenefick memorandum and kept it on his desk to remind himself of the problems raised in the memorandum. (Exhibit 90, 33-34). Baker had a discussion with Bergman about the Kenefick memorandum and criticisms of Lytle and the Mid-Continent division. (Exhibit 90, 33-34). Bergman dismissed the matter as a "personality conflict" without making any investigation. (Exhibit 90, 34). When Kenefick left Continental she did not mention the memorandum or any problems at Mid-Continent at the time. (Exhibit 90, 34). Kenefick left Mid-Continent for another job which was due in part to being offered excellent opportunities at a corporation and because she was frustrated with her experience working with Lytle. (Exhibit 90, 34).

Sometime in September of 1981, Baker, after he had read the Kenefick memorandum, became concerned about the level of Penn Square participations and asked both Bergman and Redding for current dollar totals. (Exhibit 90, 35). Each provided an estimate that was approximately half of what Baker later discovered to be the actual total of $519 million. (Exhibit 90, 35). Baker indicated that he was concerned, not only about Bergman

and Redding's ignorance of the amounts of loans involved, but about the " 'unreasonable concentration' " of loans coming through a small Oklahoma bank. (Exhibit 90, 35). Baker expressed these concerns to Bergman. (Exhibit 90, 35).

Although there was some dispute between Baker, Bergman, Redding and Lytle as to the definition of certain procedures, Baker did tell Bergman that "participation purchases from Penn Square (except for previous commitments) should be halted, and that those participations already purchased should be expeditiously converted to direct loans." (Exhibit 90, 35). Lytle indicated that he was never directed to stop purchasing participations, but rather was "encouraged" by Redding to place large loans on a direct basis. (Exhibit 90, 36). Lytle and Bergman defined large loans as those over $5 million, and Redding termed as large loans only those over $10 million. (Exhibit 90, 36).

Notwithstanding Baker's order, the vast bulk of participations were purchased, increased or renewed after Baker's order was given. (Exhibit 90, 37). Essentially, Baker's order was either not followed or misunderstood.

In November of 1981 another warning was raised. Two oil and gas engineers employed in the Mid-Continent division told Redding that they were concerned about Penn Square loans, particularly because reserve evaluations were in effect ignored because other collateral was used to justify lending more than the loan value of the reserves. (Exhibit 90, 37). Redding seemed sympathetic, told the engineers not to yield to pressure in making their evaluations, and Redding said that he

would speak to Lytle. (Exhibit 90, 37). Redding did not speak with Lytle. (Exhibit 90, 37).

Every quarter the corporate office conducted a quarterly review with each of the major operating units of the bank. (Exhibit 90, 37). The third quarter review for GBS was held in November of 1981. (Exhibit 90, 38). This meeting included Anderson, Baker, Bergman and various others. (Exhibit 90, 38). Penn Square problems were discussed. Baker introduced the topic and asked Bergman to discuss the problems. (Exhibit 90, 38). Bergman stated that there were Penn Square related "housekeeping problems" and they all related to documentation. (Exhibit 90, 38). There was no discussion at this meeting of any possible problems with the creditworthiness of these loans. (Exhibit 90, 38).

In August of 1981 Bergman asked Redding to send auditors to Penn Square, but Redding did not act promptly on this request and subsequently Baker and Bergman agreed that the bank's internal auditors should be sent to Penn Square to review Penn Square's records. (Exhibit 90, 38). The auditors made two trips and prepared two reports. (Exhibit 90, 38-42).

The first report according to the auditors was " 'a fairly negative report.' " (Exhibit 90, 40). According to Redding and Bergman, however, they believed the audit was " 'relatively clean.' " (Exhibit 90, 40). Bergman told Baker, who did not see the report, that the report was relatively clean. (Exhibit 90, 40).

In the second audit the auditors once again expressed concern and the auditors discussed with Bergman and Redding the contents of the report, including providing

them with copies, which suggested serious problems at Penn Square. (Exhibit 90, 41). Although an auditor may have told Baker during a brief conversation, perhaps in a washroom, that Penn Square " 'was pretty frail,' " Baker never saw the audit reports and was not specifically informed of their contents. (Exhibit 90, 41-42).

Perhaps one of the most significant "red flags" was the discovery in the audits of a series of personal loans at preferential interest rates being made by Penn Square to John Lytle. (Exhibit 90, 42-43). This discovery was made on December 7, 1981 and was immediately reported to Mr. Hlavka, who was a senior auditor. (Exhibit 90, 42). Hlavka initiated an investigation of Lytle's account at Continental. (Exhibit 90, 42). The investigation, both at Penn Square and Continental, revealed that Lytle's personal loans from Penn Square were in the amount of $565,000. (Exhibit 90, 42). Hlavka also concluded from his investigation that Lytle was living beyond his means. (Exhibit 90, 42).

Hlavka informed Redding, Lytle's immediate supervisor, of these loans in mid-December. (Exhibit 90, 43). Redding informed his direct superior, Bergman. (Exhibit 90, 42). According to Baker, he learned of these loans from Hlavka. (Exhibit 90, 42). Baker informed Roger Anderson at their next Friday morning meeting, which was late in December or early in January. (Exhibit 90, 42). Anderson was only told that a division manager had received a loan from a correspondent bank, and that the matter was being investigated. (Exhibit 90, 42-43). The information did not identify the division or Lytle. (Exhibit 90, 43).

On December 21, 1981, Hlavka and others met with Lytle to confront Lytle with the loans. (Exhibit 90, 43). Lytle expressed great surprise that the loans might create a conflict of interest, and stated that this was how Oklahoma bankers treated their friends and special customers. (Exhibit 90, 43). Hlavka was impressed by Lytle's open attitude toward the loans. According to Hlavka, he did not think that Lytle thought that he had done anything wrong. (Exhibit 90, 43). Hlavka advised Lytle to take his loans out of Penn Square Bank, which Lytle did. (Exhibit 90, 43). Jennings and Patterson at the Penn Square Bank helped Lytle relocate his loans at one of Penn Square's correspondent banks in Oklahoma and guaranteed those loans so the bank would take them. (Exhibit 90, 43). No one at Continental was informed that Penn Square employees had helped Lytle place his loans, and no one at Continental was informed that Penn Square employees had guaranteed Lytle's loans. (Exhibit 90, 43).

Thereafter there were various meetings that took place with various people at Continental. (Exhibit 90, 43-48). It is clear that neither Redding or Bergman ever suggested to senior management that Lytle should be terminated. (*See e.g.*, Exhibit 90 at 43). Indeed, Hlavka, the accountant in charge, was of the opinion that while Lytle had made a mistake, he should not be terminated. (Exhibit 90, 42-43). Furthermore, Bergman told Baker in late March or early April of 1982 that " 'two relatively clean audits had been performed at Penn Square.' " (Exhibit 90, 46). Baker did not only rely upon Bergman, but also contacted Hlavka around this time, and Hlavka's view that Lytle should not be terminated carried considerable weight with Baker. (Exhibit 90, 46).

In April of 1982 Roger Anderson met with Baker, Bergman, Redding, Hlavka and others to discuss the situation. (Exhibit 90, 46). At that meeting Baker and Bergman advocated keeping Lytle and imposing sanctions short of termination. (Exhibit 90, 46). Bergman, and perhaps Baker and Redding stated that the participations with Penn Square were of good quality. (Exhibit 90, 46). Mr. Hallagan of the legal department stated that Lytle should be terminated, pointing out that Lytle's action constituted a violation of the bank's code of ethics and that Lytle may have violated the law, although Hallagan did not have sufficient facts to prove Lytle's criminal intent. (Exhibit 90, 47). A representative from personnel agreed with Hallagan. (Exhibit 90, 47). This April meeting ended without any final decision by Anderson. (Exhibit 90, 47).

Between April 13, 1982 and May 12, 1982, Eugene Croisant, an executive vice president responsible for personnel, met with Roger Anderson, and they covered several topics. (Exhibit 90, 47). Included within the topics they covered was the question of whether Lytle should be terminated. (Exhibit 90, 47). Croisant advised Anderson to listen to his staff people, such as legal and personnel, rather than people from the line office who had personal involvement in the matter. (Exhibit 90, 47). Anderson responded that Hlavka, who had been silent earlier when Hlavka had been in a meeting with Anderson, had approached Anderson afterwards and expressed the opinion that Lytle had used bad judgment, but was not culpable and should not be terminated. (Exhibit 90, 47).

Thereafter, on May 12, 1982, Anderson once again met with Baker, Bergman, Redding, Hlavka, the bank's general counsel, and others. (Exhibit 90, 48). No one changed position regarding termination. (Exhibit 90, 48). As with the previous advice, there was no discussion of potential problems with the quality of Penn Square participations. (Exhibit 90, 48). Once again, Anderson concluded the meeting by saying that he wished to give the matter further consideration. (Exhibit 90, 48).

Finally, Baker and Roger Anderson had one final meeting on May 17, 1982. (Exhibit 90, 48). In a memorandum from Baker to Anderson dated May 17, 1982, Baker referred to a conversation that had occurred earlier in the day in which they had apparently decided to retain Lytle, but move him from oil and gas and give him no salary increases or incentive compensation for two years. The others were notified of this decision by circulation of a memorandum bearing the handwritten notation "Agree REA." (Exhibit 90, 48).

It is also clear, that while senior management was aware that some of its credits were "stale" in terms of rating, senior management did not encourage this practice. (Exhibit 90, 50-58). As of June 30, 1982, approximately $143.5 million or 13.4% of the approximate $1.073 billion of Penn Square-related loans and participations were unrated, and $186.7 million, or approximately 17.4%, were stale-rated. (Exhibit 90, 50). Of the $146.4 million identified by Continental as charge-offs in the second and third quarter of 1982, 50.2 million, 34.3%, were unrated, and $18.6 million, 12.7%, were stale-rated.